146 U.S. 491

RECORD, CASE No. 14,987.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1891.

TERM No., ~~1513~~. 1025

THE FARMERS' & MERCHANTS' STATE BANK AND LEVI SCOTT, APPELLANTS,

vs.

DAVID ARMSTRONG, AS RECEIVER OF THE FIDELITY NATIONAL BANK OF CINCINNATI, OHIO.

ON A CERTIFICATE FROM THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

FILED MARCH 2, 1892.

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JUDD & DETWEILER, PRINTERS, WASHINGTON, D. C., MARCH 14, 1892.

1 United States Court of Appeals for the Sixth Circuit.

THE FARMERS' AND MERCHANTS' STATE BANK and LEVI SCOTT, Appellants,
vs.
DAVID ARMSTRONG, as Receiver of the Fidelity National Bank of Cincinnati, Ohio, Appellee.
No. 8.

This cause comes before this court by appeal from a decree of the circuit court of the United States for the western division of the southern district of Ohio, sustaining the demurrer of the appellee to the bill of complaint of the appellants, and, the appellants not desiring to plead further, dismissing said bill. The transcript being presented to this court, it appears that the following questions or propositions of law arise in the cause concerning which this court desires the instruction of the Supreme Court of the United States as to their proper decision, namely:

1. Where a national bank becomes insolvent and its assets pass into the hands of a receiver appointed by the Comptroller of the Currency, can a debtor of the bank set off against his indebtedness the amount of a claim he holds against the bank, supposing the debt due from the bank to have been payable at the time of its suspension, but that due to it to have been payable at a time subsequent thereto?

2 2. Has a circuit court of the United States sitting in Ohio as a court of law jurisdiction to entertain a defense of set-off as against an action brought by a receiver appointed by the Comptroller of the Currency to wind up the affairs of a national bank doing business in Ohio because of its insolvency upon a note held by said bank, which note matured and became payable after the appointment of such receiver?

3. Where an action at law is brought in a circuit court of the United States sitting in Ohio, by a receiver appointed by the Comptroller of the Currency of an insolvent national bank doing business in Ohio, upon a note discounted by said bank, which note did not mature until after the appointment of the receiver, and the defense pleaded is a set-off of the balance of proceeds of such discount left on deposit with such bank, said deposit having been made with the understanding that any balance thereof remaining to the credit of the borrower at the time of the maturity of such note should be then applied as a credit thereon, and said defense is disallowed and judgment rendered in favor of said receiver for the full amount of said note, is such judgment a bar to a subsequent suit in equity by the borrower against the receiver to establish such set-off?

4. Where a national bank doing business in Ohio in 1887 discounts a promissory note with the understanding that the proceeds of the discount are to remain on deposit with it subject to the checks of the borrower and any balance of such deposit remaining undrawn at the maturity of the note is to be applied as a

3 credit thereon, and where at the time such discount was

made said bank was in fact insolvent and known so to be by the officer through whom it acted in making such discount and agreement, but such bank was then in good credit and thought by the borrower to be solvent, with good reason for so thinking, and where afterwards, the insolvency of said bank becoming known to the Comptroller of the Currency, that officer assumed charge of said bank and afterwards, in June, 1887, but before the maturity of the note so discounted, appointed a receiver to close up the affairs of said bank, can such borrower by suit in equity against such receiver compel a set-off of the balance of said deposit account at the time of the suspension of said bank against the amount due upon such note at its maturity?

5. If a set-off could be decreed by a court of equity upon the state of facts indicated in the preceding question, would a prior decision by a circuit court of the United States sitting in Ohio as a court of law, in an action brought by such receiver upon said note, sustaining a demurrer to a defense alleging the discount of said note, the agreement upon which it was made, and tender on the maturity of said note of a sum which, with the balance of said deposit, was equal to the amount then due upon said note, and giving judgment for said receiver for the face of said note, be a bar to relief in equity?

6. Where an action at law is brought in a circuit court of the United States sitting in Ohio, by a receiver appointed by the Comptroller of the Currency of an insolvent national bank doing
4 business in Ohio, against the maker and endorser upon a note discounted by said bank for account of the payee, who is also the sole endorser, which note did not mature until after the appointment of the receiver, of which note the maker is an accommodation maker for the benefit of the endorser and receiving no consideration for such endorsement, and this fact being known to the discounting bank at the time of the discount, and the defense pleaded is a set-off of the balance of the proceeds of such discount which were left on deposit with such bank to the credit of said endorser, part of said proceeds having been drawn on the check of the endorser and the balance remaining on deposit at the time of the appointment of the receiver, and said defense is disallowed and judgment rendered in favor of said receiver for the full amount of said note, is such a judgment a bar to a subsequent suit in equity by the maker and endorser against the receiver to establish such set-off?

7. Where a national bank doing business in Ohio in 1887 discounts a promissory note made by one person for the accommodation of the payee who is the sole endorser, with the understanding that the proceeds of the discount should be placed to the credit of the endorser upon the books of the discounting bank, and with knowledge of the character of the note, and where at the time of such discount said bank was in fact insolvent and known so to be by the officer through whom it acted in making such discount and agreement, but such bank was then in good credit and thought by the maker and endorser to be solvent, with good reasons for so thinking, and where afterwards, the insolvency of said bank be-

coming known to the Comptroller of the Currency, that
5 officer assumed charge of said bank, and afterwards, in June, 1887, but before the maturity of the note so discounted, appointed a receiver to close up the affairs of said bank, and such receiver afterwards brought an action at law against the maker and endorser of such note, to which suit the defendants, by answer, set up a claim to offset the balance of the proceeds of such note still remaining on deposit in such bank, and the circuit court rendered a judgment for the full amount of said note against said parties, can such maker and endorser afterwards, by suit in equity against such receiver, compel a set-off of the balance of said deposit account at the time of the suspension of said bank against the amount due upon such note at its maturity?

Whereupon, on motion of the appellants, by their counsel, that the said questions and propositions of law may be stated by this court and certified to the Supreme Court of the United States for its instructions thereon, it is ordered that the foregoing statement of the pleadings and the questions and propositions of law arising thereon and the following statement of facts, which is a summarized statement of the facts appearing in the bill of complaint, together with the grounds of demurrer thereto, made under the directions of the judges of this court, be certified according to the law in that case made and provided:

6 *Statement of Facts.*

Shortly before June 6, 1887, an agreement was made by the Fidelity National bank, incorporated under the banking acts of the United States, doing business in Cincinnati, Ohio, hereinafter called the Fidelity bank, by Edward L. Harper, its vice-president, and the Farmers' and Merchants' State bank, incorporated under the laws of Indiana, hereinafter called the State bank, that said Fidelity bank should loan to said State bank ten thousand dollars, less a discount thereon at the rate of seven per cent. per annum, for ninety days; that the money so borrowed, less said discount, should be placed to the credit of said State bank upon the books of said Fidelity bank, subject to the order of said State bank, as evidenced by its checks or drafts upon said Fidelity bank, and that said loan should be evidenced by a promissory note dated at Cincinnati, Ohio, for $10,000, payable ninety days after date, with interest after maturity at the rate of 8 per cent. per annum until paid, to be executed by the appellant, Levi Scott, to the order of said State bank and by it endorsed to the order of said Fidelity bank.

Said note was executed as thus agreed, dated and discounted on the 6th day of June, 1887. The proceeds of said discount, viz., $9,819.17, were placed to the credit of said State bank upon the books of said Fidelity bank. Afterwards and before the 20th day of June said State bank drew against said deposit the sum of $1,009.23.

On the 20th day of June, 1887, said Fidelity bank was closed
7 by order of the bank examiner of the United States, and

thereafter remained closed. On June 27, 1887, the Comptroller of the Currency of the United States, having become satisfied that said Fidelity bank was insolvent, appointed the appellee, David Armstrong, receiver of said bank to wind up its affairs, as provided under the authority given by the laws of the United States in such case made and provided, and said receiver qualified and entered upon the performance of his duties as such. On July 12, 1887, the charter of said Fidelity bank was forfeited and said banking association dissolved by decree of the circuit court of the United States for the southern district of Ohio.

On the maturity of said note said State bank tendered to said receiver the sum of $1,190.06, being the balance then due upon said note after crediting thereon the balance of said deposit account. Said receiver refused to receive the tender. Said State bank has kept said tender good.

On October 19, 1887, said receiver brought an action at law against said State bank and said Scott in the circuit court of the United States for the southern district of Ohio, claiming to recover upon said promissory note $10,000, with interest, at 8 per cent. per annum, from September 7, 1887. Said State bank and said Scott stated in defense the agreement under which said note was made and the other circumstances and tender above referred to, and said State bank prayed the amount due to it from said Fidelity bank might be set off against the amount due from it upon said note according to its tenor, and that said receiver might be required to accept the sum tendered him in full payment of the balance due on said note. Said receiver demurred to said defenses for that they
8 failed to state a defense and a valid set-off to the cause of action set forth in his petition. Said demurrers were sustained by the court, and on December 22, 1888, judgment was rendered that said set-off be disallowed and dismissed, and that said receiver recover from said State bank and said Scott $10,833.33, with interest from the first day of the term of court then current, and his costs. On January 24, 1889, a writ of error was issued to said circuit court from the Supreme Court of the United States on the complaint of said State bank and said Scott, and the record and proceedings of said cause in said circuit court were sent and removed to said Supreme Court, where the same is now depending upon said writ of error. On January 24, 1889, a supersedeas bond was given staying execution upon said judgment during the pendency of said writ of error.

To the bill of complaint of said State bank and Scott, setting forth in detail the facts above summarized and averring, further, that said Fidelity bank was in good credit at the time said discount was made and was then thought by said Scott and said State bank, with good reason for so thinking, to be solvent, but was in fact insolvent and known so to be by said Harper, and that said Scott and said State bank were advised said circuit court sitting as a court of law had not jurisdiction to entertain and adjudge upon the set-off pleaded as aforesaid, and that relief should be sought in a court of equity, and reiterating the tender and praying, among other things,

that the collection of the judgment at law might be enjoined, and that the set-off might be established and allowed, the defendant
9 Armstrong, as receiver, demurred, alleging for grounds:

1. That it appeared from the bill that the complainants were not entitled to the relief sought.

2. That the complainants had an adequate remedy at law for the relief sought, which had been already adjudicated.

This demurrer was sustained, the bill dismissed, and the cause appealed to this court, as hereinbefore stated.

Ordered that a copy hereof, certified under the seal of the court, be transmitted by the clerk to the Supreme Court of the United States.

Approved.

HOWELL E. JACKSON,
Circuit Judge.

HENRY B. BROWN,
Asso. Just. Sup. C't.

10 United States Circuit Court of Appeals for the Sixth Circuit.

I, Walter S. Harsha, clerk of the United States circuit court of appeals for the sixth circuit, do hereby certify that the foregoing 9 pages, numbered from 1 to 9, inclusive, contain a true copy of the order certifying case to U. S. Supreme Court and statement of facts by the court in the case of The Farmers' & Merchants' State Bank and Levi Scott *vs.* David Armstrong, as receiver of the Fidelity National Bank of Cincinnati, Ohio, No. 8, October term, 1891, as the same remains upon the files and records of said United States circuit court of appeals for the sixth circuit and of the whole thereof.

Seal United States Circuit Court of Appeals, Sixth Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States circuit court of appeals, at the city of Cincinnati, this 6th day of February, A. D. 1892.

WALTER S. HARSHA,
Clerk of the United States Circuit Court of Appeals for the Sixth Circuit.

[Endorsed:] United States circuit court of appeals for the sixth circuit. The Farmers' and Merchants' State Bank & Levi Scott *vs.* David Armstrong, receiver of the Fidelity National Bank of Cincinnati, Ohio. Clerk's certificate.

Endorsed on cover: Case No. 14,987. Court of appeals, sixth circuit. Term No., 1513. The Farmers' & Merchants' State Bank and Levi Scott, appellants, *vs.* David Armstrong, as receiver of the Fidelity National Bank of Cincinnati, Ohio. Filed March 2d, 1892.

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JAMES H. McKENNEY,
CLERK.

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Supreme Court of the United States.

OCTOBER TERM, 1892.

Levi Scott et al.
Plaintiffs in Error,

v.

David Armstrong, Receiver, etc.
Defendant in Error.

Farmers' and Merchants' State Bank et al.
Appellants,

v.

David Armstrong as Receiver, etc.
Appellee.

BRIEF FOR PLAINTIFFS IN ERROR AND APPELLANTS.

Jno. Warrington

J. W. WARRINGTON,
Of Counsel.

Supreme Court of the United States.

LEVI SCOTT, and THE FARMERS' and MERCHANTS' STATE BANK, Plaintiffs in Error, *v.* *DAVID ARMSTRONG, Receiver of the Fidelity National Bank of Cincinnati, Ohio, Defendant in Error.*	*Error to Circuit Court for Southern District of Ohio, Western Division.*
THE FARMERS' and MERCHANTS' STATE BANK and LEVI SCOTT *v.* *DAVID ARMSTRONG, as Receiver of the Fidelity National Bank of Cincinnati, Ohio.*	*On Certificate from U. S. Circuit Court of Appeals for the Sixth Circuit.*

BRIEF FOR PLAINTIFFS IN ERROR AND APPELLANTS.

These two cases arise out of the same transaction, and at the October Term, 1891, were ordered to be heard together.

Statement of the Error case.

The plaintiff below, defendant in error, as receiver winding up the affairs of the Fidelity National Bank of Cincinnati, Ohio, on October 19th, 1887, brought an action at law, in the Circuit Court of the United States for the Southern District of Ohio, Western Division, against the defendants below, plaintiffs in error, Scott as maker, and the Farmers' and Merchants' State Bank as indorser, of a promissory note for $10,000, dated Cincinnati, O., June 6, 1887, payable ninety days after date at said Fidelity National Bank, with interest after maturity at the rate of eight per cent. per annum; and indorsed to the order of the Fidelity National Bank. The petition (Rec. pp. 1–2), is in the short form permitted in such cases by the Ohio statutes.

The defendant Scott pleaded that he signed the note without consideration, and under an agreement that he was not to be looked to for payment; see his amended answer, Rec. pp. 9–10.

The defendant bank pleaded the same agreement as Scott, and a set-off as to $8,809.94, arising out of the following circumstances: The note was made pursuant to a previous written agreement by the Fidelity National Bank to enter a credit on its books to the Farmers' and Merchants' State Bank (which, for brevity, we shall hereafter call the "State Bank"), for $10,000, less a discount at seven per cent. per annum; on delivery of the note this credit was given; a check was drawn against it for $1,009.23; and the balance of $8,809.94 remained on deposit in the Fidelity National Bank when the plaintiff was appointed its receiver. As to the residue of $1,190.06, to equal the face of the note, a tender at maturity was pleaded. See amended answer, Rec. pp. 7–8.

To these defenses the defendant demurred, assigning as cause as to Scott, that the facts stated constituted no defense; and as to the State Bank that the facts stated neither a defense nor a valid set-off. Rec. pp. 14–15.

The demurrers were sustained and, the defendants failing to plead further, judgment was entered for the plaintiff at the October term, 1888, for $10,833.33, with interest at eight per centum per annum from October 2, 1888, the first day of that term, and costs. The amount of the judgment was the face of the note with interest from its maturity at the above rate to the first day of the term. The judgment contained a certificate that the State Bank was liable therefor as principal, and Scott as surety; this being in accordance with the Ohio statutes, in such cases; Rev. Stat. of Ohio, Sec. 5419. Rec. p. 15.

The opinion of the Circuit Court was announced by Judge Sage, and will be found on pp. 11–13, of the record. It is also reported in 36 Fed. 63. The gist of it is that, considering that the claim due the Fidelity National Bank had not matured at the time of its failure, to allow a set-off against it would be to prefer the claim set off contrary to the provisions of the National Banking Act, and particularly to Rev. Stat. U. S., secs. 5242, 5234 and 5236.

The opinion as printed in the record states that the circuit judge

(Judge Jackson) concurs in its conclusions as being in accord with his opinion in *The National Bank* (misprint for *Bung*) *Co.* v. *Armstrong, Receiver.* This opinion is reported in 34 Fed. 94.

A writ of error was sued out on January 24, 1889; Rec. pp. 20–21. The assignment of errors will be found on pp. 19–20, of the record, and is, in substance, that the court below erred:

1. In sustaining the demurrer to the amended answer of Levi Scott.

2. In sustaining the demurrer to the amended answer of the State Bank.

3. In rendering judgment against Scott and the State Bank.

Statement of the Appeal Case.

After the suing out of the writ of error, it occurred to counsel for Scott and the State Bank, that possibly it might be urged in this court that the relief sought by way of set-off could not be administered by the Circuit Court sitting as a court of law, but only by a court of equity. No objection of this nature had thitherto been suggested by counsel on either side or by the court; the attention of all had been directed to the main question—was there a ground for relief? And the subsidiary question—in what forum should relief be sought?—was lost sight of.

To prevent a delay of justice from such a cause, and to raise the question in every forum which could, by possibility, have cognizance of it, a bill in equity was filed on February 28, 1891, in the same Circuit Court, on behalf of the State Bank and Scott against Armstrong, as receiver, in which were set forth the facts stated in the former amended answer, with some additional matters relating to the making of the loan and insolvency of the Fidelity National Bank, and the recovery of the judgment at law and pendency of the writ of error; and an injunction against the judgment, and enforcement of the set-off, were prayed. To this bill Armstrong demurred. His demurrer was sustained, the bill dismissed, and an appeal to the court of appeals for the sixth circuit perfected. The latter court has certified to this court for its decision seven questions, together with a summarized statement of the matters set forth in the bill and demurrer thereto, in accordance with sec.

6 of the appellate courts' act of March 3, 1891, and rule 37 as to the practice in this court. Some of the questions are addressed to general propositions of law, and some to the rights arising on special and particular states of facts. The latter are somewhat varied, to cover an anticipation by the defendant Armstrong that, should a trial on the facts become necessary, the plaintiffs may fail to sustain some of the allegations in the bill.

To repeat at large those questions and the statement of facts would but be to reprint here the whole record certified to this court; and we assume that such is not the wish of the court, nor within the requirement of rule 21.

Endeavoring to be as concise as substantial accuracy will permit, the following is submitted as a fair statement of the facts, and propositions of law arising thereon, the decision of which will determine both cases.

A national bank in Ohio discounted for the payee a note indorsed to it by the payee, known to have been made for the payee's accommodation, and held the proceeds on deposit to credit of payee, subject to check; all being done pursuant to a prior agreement with the payee for a loan to it. Before the loan matured the national bank suspended payment, and a receiver was appointed by the comptroller of the currency to wind it up. Part of the proceeds of the discount still remained on deposit when the bank suspended and when the receiver was appointed; and there had been no other credit to the deposit account.

1. Do such facts give the payee and maker, principal and surety, the right to set off the balance of the deposit account against the note?

2. If so, can such set-off be had in an action at law, brought by the receiver of the bank, in his own name, upon the note, against the maker, and the payee as indorser, in a circuit court of the United States sitting in Ohio?

3. If the preceding question be answered in the negative, would a judgment at law in such action, denying such a set off, bar a subsequent suit in equity to enforce it?

4. If the prior judgment at law would ordinarily be such bar,

would it be so where it was rendered on plaintiff's demurrer to defendants' plea of set-off, and it further appeared in the subsequent suit in equity, though not in the action at law:

(*a*) That the loan was made upon the understanding that the balance remaining on deposit when the note matured should be credited thereon?

(*b*) Or, that the national bank, though in good credit, and supposed by both borrower and surety to be solvent, when the loan was made, was in fact then insolvent, and known so to be by its officer through whom it made the loan?

Giving an affirmative answer to the first of these questions, as we contend should be done, involves the maintenance of two propositions:

(*a*) The facts present a case where a set-off will be allowed either at law or in equity, unless the national banking act forbids.

(*b*) There is no such prohibition in that act.

Case for Set-Off Presented.

Forms of procedure prevented courts of law from entertaining pleas of set-off at common law; their jurisdiction in this regard has always depended altogether upon statute. Courts of equity, however, have always been possessed of the doctrine of set-off, and have administered that relief both independently, and in aid of such statutes.

Since the repeal of the bankruptcy act there has been no special provision as to set-off in the legislation of congress, except as to claims against the government.

Hence the statutes of Ohio, relating to set-off, are enabling acts to the federal courts sitting in that state as courts of law, in so far as they confer rights which a court of law can properly administer; for we take it that the principle declared in *United States* v. *Robeson*, 9 Peters, 319, and again in *United States* v. *Eckford*, 6 Wall. 484, with reference to the right of set-off being such only as is conferred by the acts of congress, applies solely to claims for and against the United States. See

Stewart v. *Anderson*, 6 Cranch, 203.

Corser v. *Craig*, 1 Wash. C. C. 424.
Partridge v. *Insurance Co.*, 15 Wall. 573, 580.
Dushane v. *Benedict*, 120 U. S. 630.

The statutes of Ohio pertinent to the question are Rev. Stat., secs. 3171 to 3174 inclusive, as to negotiable instruments, and secs. 4971, 4993, 5057, 5059, 5068 to 5077 inclusive, 5315 and 5329, as to procedure. These sections are printed in the margin.

Sec. 3171. All bonds, promissory notes, bills of exchange, foreign and inland, and checks, for a sum certain, and payable to any person or order, or to any person or assigns, shall be negotiable by indorsement thereon, and all such instruments payable to a person or bearer, shall be negotiable by delivery, so as absolutely to transfer and vest the property thereof in each and every indorsee or holder successively.

Sec. 3172. An indorsee, or a holder, to whom any such bond, note, bill of exchange, or check, is made payable by such indorsement or delivery, may, in his own name, institute and maintain an action thereon, for the recovery of the money due on the same, against the maker, drawer, or obligor; or, after the use of due diligence to obtain the money of the maker, drawer, obligor, or acceptor, such action may be instituted against the indorser.

Sec. 3173. If any such bond, note, bill of exchange, or check, be indorsed or delivered after the day on which it is made payable, and the indorsee institute an action thereon against the maker, drawer, or acceptor, the defendant shall be allowed to set up any defense he might have made, had the action been instituted in the name and for the use of the person to whom the bond, note, bill, or check was originally made payable.

Sec. 3174. If any such bond, note, bill of exchange, or check, be indorsed or delivered on or before the day on which the same is made payable, and the indorsee institute an action thereon, the defendant may prove the payment of any money thereon before the same was indorsed or delivered to the plaintiff, on proving that the plaintiff had notice of the payment before such indorsement was made and accepted or such delivery made.

Sec. 4971. There shall be but one form of action, which shall be known as a civil action.

Sec. 4993. An action must be prosecuted in the name of the real party in interest, except as provided in sections forty-nine hundred and ninety-four and forty-nine hundred and ninety-five; but when a party asks that he may recover by virtue of an assignment, the right of set-off, counter-claim, and defense, as allowed by law, shall not be impaired.

Sec. 5057. The forms of pleading in civil actions in courts of record, and the rules by which their sufficiency shall be determined, are those prescribed in this chapter.

Sec. 5059. The only pleadings allowed, are—

1. Petition.
2. Demurrer.
3. Answer; which, when affirmative relief is demanded therein, may be styled cross-petition.
4. Reply.

Sec. 5068. The plaintiff may demur to a counter-claim, set-off, or defense consisting of new matter contained in the answer, on the ground that it is insufficient in law, on its face.

Sec. 5069. The plaintiff may also demur to a counter-claim or set-off upon which the defendant demands an affirmative judgment, when it appears on its face either—

1. That the court has no jurisdiction of the subject thereof.
2. That the defendant has not legal capacity to recover upon the same.

The extent to which a federal court of law may enforce the right and adopt the procedure thus established will more readily be considered in the discussion of the second of the questions above stated. For the present we are concerned only with what is the nature of the right of set-off thus recognized by statute.

Secs. 5075, 5072 and 4993 impose no restrictions upon the rights

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3. That there is another action pending between the same parties, for the same cause.

4. That the counter-claim is not of the character specified in section five thousand and seventy-two.

5. That the counter-claim or set-off does not state facts sufficient to entitle the defendant to the relief demanded.

Sec. 5070. The answer shall contain—

1. A general or specific denial of each material allegation of the petition controverted by the defendant.

2. A statement of any new matter constituting a defense, counter-claim, or set-off, in ordinary and concise language.

Sec. 5071. The defendant may set forth in his answer as many grounds of defense, counter-claim, and set-off as he has, whether they are such as have been heretofore denominated legal or equitable, or both; he may claim therein relief touching the matters in question in the petition against the plaintiff, or against other defendants in the same action; and each must be separately stated and numbered, and they must refer in an intelligible manner to the cause of action which they are intended to answer.

Sec. 5072. The counter-claim mentioned in the preceding section must be one existing in favor of a defendant, and against a plaintiff, between whom a several judgment might be had in the action, and arising out of the contract or transaction set forth in the petition as the foundation of the plaintiff's claim, or connected with the subject of the action.

Sec. 5073. If a defendant omit to set up a counter-claim or set-off, he can not recover costs against the plaintiff in any subsequent action thereon; but this section shall not apply to causes of action which are stricken out of or withdrawn from the answer, as provided in sections five thousand and seventy-four and five thousand and eighty-nine.

Sec. 5074. When it appears that a new party is necessary to a final decision upon the counter-claim, the court may either permit the new party to be made by a summons, to answer the counter-claim, or may direct the counter-claim to be stricken out of the answer, and made the subject of a separate action.

Sec. 5075. A set-off can only be pleaded in an action founded on contract, and must be a cause of action arising upon contract, or ascertained by the decision of a court.

Sec. 5076. If a new party be necessary to a final decision upon the set-off, the court shall permit the new party to be made, if, owing to the insolvency or non-residence of the plaintiff, or other cause, the defendant will be in danger of losing his claim, unless permitted to use it as a set-off.

Sec. 5077. When cross-demands have existed beween persons, under such circumstances that if one had brought an action against the other a counter-claim or set-off could have been set up, neither can be deprived of the benefit thereof by assignment by the other, or by his death, but the two demands must be deemed compensated, so far as they equal each other.

Sec. 5315. If a set-off or counter-claim be pleaded, the defendant shall have the right of proceeding to the trial of his claim, although the plaintiff has dismissed his action, or fails to appear.

Sec. 5329. When a counter-claim or set-off, established at the trial, exceeds the plaintiff's claim so established, judgment for the defendant must be given for the excess; or, when it appears that the defendant is entitled to any affirmative relief, judgment shall be given therefor.

of set-off, counterclaim, and assignment, which had not previously been recognized by courts of equity.

The English statutes of set-off, excepting those as to set-off in bankruptcy, did not *declare* a set-off to be payment *pro tanto, ex proprio vigore*, in any case; they merely established a mode of procedure by which a party might secure its being so declared by a court of law in certain cases, if he saw fit to avail himself of it. Sec. 5077 seems to differ, in that it declares *compensation* in the civil law sense of that term; but it is apparent from sec. 5073 that such compensation is not payment absolute, but — like the set-off under the English statutes—conditional upon application to the court. Nor was this section (5077) intended to set limits upon the right of set-off, and refuse application thereof in cases not falling within its terms; this is apparent from the other sections above referred to, and from sec. 5071, which recognizes as valid, and authorizes all courts of general jurisdiction to enforce, all rights of set-off theretofore considered good in equity.

Hence in *Wagner* v. *Stocking*, 22 Ohio, St. 297, where the defendants, being principal and surety, were allowed to set off a debt due from plaintiff to the principal, the court said, p. 302:

"Our code, however, as we have seen," referring to a quotation earlier in the opinion of what is now sec. 5071, "authorizes the defendant in an action to set up an equitable as well as a legal set-off. If, therefore. the set-off in question was available in equity before the code was adopted, it was equally so in the 'civil action' by which, under its provisions, both legal and equitable remedies are administered."

And in *Bank* v. *Hemingray*, 34 Ohio St. 381, and *Baker* v. *Kinsey*, 41 Ohio St. 403, a purely equitable set-off was again allowed. The same principle was again declared in *Armstrong* v. *Warner*, 27 Weekly Law Bulletin, 330, to which we shall have occasion to refer more fully hereafter, in discussing the national banking act.

It may therefore be considered as settled that the statutes of Ohio do not prohibit, but on the contrary expressly grant, what is known as an equitable set-off.

If, as we shall contend hereafter, there be nothing in the na-

tional banking act prohibiting a depositor in an insolvent bank setting off his deposit account against his note held by the bank, although not due at the time of the appointment of the receiver; and if, as we shall also contend, the receiver is not an *assignee* of the note; then, notwithstanding the appointment of the receiver, when the note matured there were matured cross-demands existing between the same parties; and the right of set-off is given expressly by Ohio Rev. Stat., sec. 5077.

Upon the other hand, if the receiver be an assignee of the note, yet he is but an assignee for the benefit of creditors, and acquires no greater rights than would such an assignee; and if equity would permit a depositor in an insolvent bank, when sued by its assignee for creditors upon a note discounted by it and maturing after the insolvency, to set off the balance of his deposit account, so likewise would it permit the depositor in a national bank as against its receiver—there being no special provisions of the national banking act to the contrary. That such facts do present a case of equitable set-off is well settled.

The first statute granting the right of set-off was the bankruptcy act of 1705, 4 Anne, c. 17, where it was provided by sec. 11 that in cases of mutual credit, the commissioners in bankruptcy should adjust the account, and collect, or pay dividends upon, the balance only.

The first statute of set-off applicable otherwise than in bankruptcy was the act of 1729, 2 Geo. II, c. 22, sec. 13.

The act of 4 Anne, however, was but a statutory recognition of what was already the settled practice of the chancery in settling estates under the prior bankrupt act of 13 Eliz., c. 7.

Anonymous, 1 Modern, 215 (*anno* 1676).
Curson v. *African Co.*, 1 Vernon, 121 (*anno* 1682).
Chapman v. *Derby*, 2 Vernon, 117 (*anno* 1689).
Eden on Bankruptcy, 186.

And prior to the act of 2 Geo. II, courts of equity were used to decree a set-off in certain cases upon the ground of natural equity, where there had been mutual credit resulting in cross-demands and one of the parties was insolvent, and this although the insol-

vent's claim had passed to another, and although that other was an assignee for creditors, *e. g.* an executor.

Peters v. *Soame*, 2 Vernon, 428 (*anno* 1701).

Ld. Lanesborough v. *Jones*, 1 P. Wms. 325 (*anno* 1716).

Downam v. *Matthews*, Prec. in Chanc. 580, pl. 350 (*anno* 1721).

Jeffs v. *Wood*, 2 P. Wms. 128 (*anno* 1723).

Hawkins v. *Freeman*, 2 Eq. Cas. Abr. 10 pl. 10 (*anno* 1723).

As to what constitutes a mutual credit sufficient to raise this natural equity, judges have differed. It was declared by Mr. Justice Story in *Green* v. *Darling*, 5 Mason, 201, 213 (*anno* 1828), after a review of many of the decisions theretofore made, that "the mere existence of distinct debts without mutual credit did not give a right of set-off in equity;" and in section 1435 of his treatise on Equity Jurisprudence, he defines mutual credit in the sense here used, as "a knowledge on both sides of an existing debt due to one party, and a credit by the other party, founded on, and trusting to such debt, as a means of discharging it."

This definition seems hardly broad enough to permit the set-off allowed in *Hankey* v. *Smith*, 3 Term, 507, note (although this was a decision under the bankrupt act, yet it is pertinent as showing the meaning of the phrase "mutual credit" in the law); and it seems fully broad enough to justify the set-off disallowed in *Fuller* v *Steiglitz, Assignee*, 27 Ohio St. 355.

But it is not necessary to pursue further the decisions upon the *quantum* of connection between the claims, or of mutual knowledge as to the reciprocal relation, necessary to raise the equity of set-off; for in the case at bar each bank was aware of its indebtedness to the other when it gave credit to that other, and the reciprocal credits were but parts of one and the same transaction; each gave credit to the other because of, and on the faith of, the simultaneous credit given by the other to it. That such a case is one of mutual credit under the most restricted definition of that term is apparent; nor has this been denied in any decision of which we are aware.

While the authorities all agree, however, that reciprocal de-

mands so created present a case of mutual credit within the doctrine of courts of equity as to set-off; and while they further agree that a mere trustee for creditors, whether by voluntary assignment, or by operation of law, as an assignee in bankruptcy, or insolvency, or an executor or administrator, takes the property of the assignor subject to all claims and defenses which a court of equity would, at the time of the assignment, sustain against the assignor—no statute declaring otherwise; yet they differ as to when set-off can be successfully claimed against such an assignee; in other words, they differ as to whether the concurrence merely of mutual credit and insolvency of one of the parties establishes a right of set-off against the insolvent sufficiently matured to survive an assignment by the insolvent, and to be thereafter available against his assignee, although such assignment were without a new and valuable consideration.

In New York, Pennsylvania, and some other states, it is held that although there be mutual credit and insolvency, yet if the debt owing by the insolvent had not become payable at the time of his assignment, there can ordinarily be no set-off as against his assignee; that the equity of set-off is not complete until the claim which is so to be asserted has become payable, for otherwise a person would be compelled to pay his debts before they matured; and that any assignment of a claim before its maturity will defeat and destroy the right of set-off which might otherwise grow out of mere mutual credit.

Bradley v. *Angel*, 3 N. Y. 475.
Martin v. *Kunzmuller*, 37 N. Y. 396.
Bosler v. *Exchange Bank*, 4 Barr, 32.
Chipman v. *Ninth Nat. Bank*, 120 Pa. St. 86; s. c., 12 Central Rep. 296.

We take it that the real reason why natural equity demands that mutual credit should result in a right of set-off, is that given by Lord Macclesfield and Sir Joseph Jekyll, in the early cases already cited, *Downam* v. *Matthews*, Prec. in Chancery, 580, pl. 350 (*anno* 1721), and *Jeffs* v. *Wood*, 2 P. Wms. 128 (*anno* 1723), viz: that such mutual credit is proof of

an implied agreement for a set-off; and so Mr. Justice Story seemed to think, 2 Story's Equity, sec. 1435; *Green* v. *Darling*, 5 Mason, 215. This being so, it is evident that the decisions in New York and Pennsylvania, above cited, and others like them, can not be sustained; they proceed upon a false hypothesis; they assume that there is no right to a set-off until the debt which is to be so used has matured. But if set-off is decreed because the mutual credit shows the parties have so agreed, then the right to set-off dates back to the time the credit was given; the decree is nothing but the ordinary equitable remedy of specific performance, given wherever the law will not furnish adequate relief; the equity of a right to specific performance, thus created by the mutual credit, is perfect when insolvency makes apparent the inadequacy of the relief at law, and is superior to any subsequent equity not arising out of a purchase for value without notice, and this although such subsequent equity arose before the time fixed for the performance of the contract.

Accordingly this court has thrice declared that where there has been mutual credit coupled with insolvency, the time when the debts respectively mature is not material; that a right of set-off enforcible in equity already exists against the insolvent, which can not be defeated by his assignment to one not taking for value and without notice.

Scammon v. *Kimball*, 92 U. S. 362.
Schuler v. *Israel*, 120 U. S. 506, 510.
Carr v. *Hamilton*, 129 U. S. 252, 262.

The first of these cases, it is true, was under the bankruptcy act; but this is not material, for that statute "was not intended to enlarge the doctrine of set-off in cases where the principles of legal or equitable set-off did not previously authorize it." *Sawyer* v. *Hoag*, 17 Wall. 610, 622.

These decisions undoubtedly confirm the right of set-off here claimed as being within the established principle of equitable set-off, and would seem to foreclose discussion on that point in this court. To the same effect are the very recent decisions in *Armstrong* v. *Warner* (Ohio), 27 Weekly Law Bulletin, 330; *Fidelity*

Trust & Safety Vault Co. v. *Merchants' Nat. Bank* (Ky.), 9 L. R. A. 108, and *Nashville Trust Co.* v. *Fourth Nat. Bank* (Tenn.), 15 L. R. A. 710; and other cases to the same effect might be cited.

But, if the point of difference above mentioned were still debatable in this court, it is needless in the case at bar to extend the discussion further, or consider on which side lies the weight of reason and authority; for in both New York and Pennsylvania it is conceded that, if the debt owing *by* the insolvent had matured at the time of his death, or assignment for creditors, it may be set off against a debt owing *to* him which at that time had not matured.

Smith v. *Felton*, 43 N. Y. 419.
Smith v. *Fox*, 48 N. Y. 674.
Richards v. *La Tourette*, 119 N. Y. 54.
Skiles v. *Houston*, 110 Pa. St. 254; s. c., 1 Central Reporter, 378.

The right of set-off under such circumstances has been recognized in Ohio.

Bank v. *Hemingray*, 34 Ohio St. 381.
Armstrong v. *Warner*, 21 Weekly Law Bull. 136.
Same v. *Same*, 27 Id. 330.

And the decisions in other states are to the same effect.

Receivers v. *Patterson Gas-Light Co.*, 3 Zabr. 283.
Smith v. *Spengler*, 83 Mo. 408.
McCagg v. *Woodman*, 28 Ill. 84.
Colt v. *Brown*, 12 Gray, 233.

Although a general deposit in bank is a debt payable on demand, and consequently does not mature ordinarily until demand has been made, yet it matures without demand where the bank becomes insolvent; for demand then would be futile, and the law does not require the doing of a vain thing.

Hence this court, speaking of such a deposit, said in *Richmond* v. *Irons*, 121 U. S. 27, 64:

"In the case of book accounts in favor of depositors, which was the nature of the claims in this case, interest would begin to accrue

as against the bank from the date of its suspension. The act of going into liquidation dispenses with the necessity of any demand on the part of the creditors, and it follows that interest should be computed upon the amounts then due as against the share-holders to the time of payment."

Of course, interest could not run unless the claim on the deposit had matured. In the cases last cited from Pennsylvania, Ohio, New Jersey, Missouri, and Illinois, the insolvent was a banker, and among the claims which were allowed to be set off, and decided to have been matured by the insolvency, were general deposits with the banker.

As the dealings between the Fidelity Bank and the State Bank present a case of mutual credit, and as the claim of the State Bank was for a balance due it upon a deposit account, which matured and became suable at once upon the suspension of the Fidelity Bank, we submit that it is clear beyond a doubt that as against the receiver of the Fidelity Bank, suing upon the claim due the latter, though maturing after that bank's suspension, the State Bank had the right, aside from any provision to the contrary in the National Banking Act, to set off the balance due it upon its deposit account; and that, if such set-off could not be made at law, it certainly could in equity. We, therefore, pass on to the next proposition.

The National Banking Act does not prohibit Set-Off.

Examination of this act shows that there is no express prohibition against the application of the doctrine of set-off in any case. If such prohibition is there to be found, it is by inference. The only provisions from which it has ever been claimed, so far as we are aware, that such inference can be drawn, are the sections cited by the learned district judge in his opinion in the error case now under review, viz.; Rev. Stat. of U. S., secs. 5234, 5236 and 5242. These are contained in the chapter relating to the winding up of insolvent national banks, and, so far as material, are as follows:

Sec. 5234 provides for the appointment of a receiver, by the comptroller of the currency and defines his duties, as follows:

"Such receiver, under the direction of the Comptroller, shall take possession of the books, records and assets of every description of such association, collect all debts, dues, and claims belonging to it, and, upon the order of a court of record of competent jurisdiction, may sell or compound all bad or doubtful debts, and, on a like order, may sell all the real and personal property of such association, on such terms as the court shall direct; and may, if necessary to pay the debts of such association, enforce the individual liability of the stockholders. Such receiver shall pay over all money so made to the Treasurer of the United States, subject to the order of the Comptroller, and also make report to the Comptroller of all his acts and proceedings."

Sec. 5235 relates to proof of claims against the bank.

Sec. 5236 directs that after full provision shall have been made for redeeming the circulating notes:

"The Comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated;" and pay the remainder of the proceeds, if any, to the share holders *pro rata*."

Sec. 5242 reads:

"All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor; all deposits of money, bullion or other valuable thing for its use, or for the use of any of its shareholders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in payment of its circulating notes, shall be utterly null and void; and no attachment, injunction or execution, shall be issued against such association or its property before final judgment in any suit, action or proceeding, in any state, county, or municipal court."

It is said these sections by implication forbid set-off, because

they require, as stated by this court in *National Bank* v. *Colby*, 21 Wall. 609, and *Pacific Nat. Bank* v. *Mixter*, 124 U. S. 721, that after the redemption of the circulating notes has been fully provided for, the assets shall be *ratably* distributed among general creditors, and that no preferences given or suffered in contemplation of, or after, committing an act of insolvency, shall stand. But the court in those cases did not mean, nor does the national banking act contemplate, that *all* creditors must be *general*, that *no* creditor can have *security*. Liens, securities, or pledges, given in contemplation of, or after, insolvency by way of preference, or to prevent an equal distribution of present assets among present creditors, are void; *Nat. Security Bank* v. *Butler*, 129 U. S. 223. But pledges resting solely upon a new and contemporaneous consideration, though given in contemplation of insolvency, are valid as against the receiver. *Casey* v. *La Société de Credit Mobilier*, 2 Woods 77; affirmed upon this point by *Casey* v. *Schneider*, 96 U. S. 496; *Armstrong* v. *Chemical National Bk.*, 41 Fed. Rep. 234; s. c., 6 L. R. A. 226. And any other lien, security, or right, created by the will of the parties prior to insolvency and not in contemplation thereof, or given by the law otherwise than by the forbidden processes of attachment, injunction, or execution, before judgment, is equally valid.

Sec. 5234 authorizes the receiver to convert into money the *assets* of the bank; and sec. 5236 requires the comptroller from that money to pay ratable dividends. If these sections stood alone, the question would be merely—what are the assets of the bank? And the answer would be—the property owned by the bank at the time to which the appointment of the receiver related in law, subject to all liens, rights and equities of every nature then existing, together with a right of action to recover any property theretofore disposed of by the bank while insolvent, or in view of probable insolvency, without consideration, *i. e.*, the right of action any judgment creditor would have had to procure the setting aside of a fraudulent transfer had no receiver been appointed. But all liens, preferences, privileges, and equities, granted by the bank for a real consideration, would have stood; and so also all liens, preferences, privileges, and equities arising by rule of law without

the intentional or voluntary concurrence of the bank, for the law never grants a right except upon a sufficient consideration. We take it this statement needs no citation of authority in its support; but if such should be given, it will be found in the cases heretofore cited establishing the right of set-off. For it is the application of this principle which has led to the enforcement almost universally of the rule that a right to a set-off good in law or equity against an insolvent estate at the time of an assignment for creditors, or appointment of an official liquidator, continues good thereafter, in the absence of express statutory provisions to the contrary; and the inherent equity of the principle has received recognition in almost all statutory schemes of bankruptcy, by the enlargement there given to the legal, as distinguished from the equitable, remedy of set-off.

Sec. 5242 enlarges what would otherwise have been the *assets* of the insolvent bank, by permitting the general creditors to avoid certain transfers and liens which would otherwise have stood as good not only against the bank, but against its creditors by judgment or otherwise. Examination of its provisions, however, shows that it is not directed against *all* liens or equities whereby one creditor may obtain a greater proportionate payment on his claim than another, but against certain of these only, viz., those arising from the voluntary act of the bank after or in contemplation of the commission of an act of insolvency, and without a new consideration, and those arising *in invitum*, actually or apparently, by the process of attachment, injunction, or execution, before final judgment.

It is obvious that set-off does not fall within the prohibited classes of liens obtained *in invitum* by process; and no more need be said on that head.

It is equally apparent that set-off *per se* does not fall within the prohibited voluntary transfers; for it either arises out of a contract expressly made between the parties, or implied from the nature of their dealings, and supported by a new and contemporaneous consideration, or is deduced by the law as a right established because of acts done by them.

It is only when one of those acts is a transfer, assignment, or

deposit made by the bank after, or in contemplation of, the commission of an act of insolvency, either without consideration, or in whole or part for a consideration not contemporaneous, that sec. 5242 prevents a set-off from arising; and then it is not because set-off is prohibited, but the act out of which the set-off might otherwise grow. Annulling the act cuts off its legal consequences.

If any set-off arising otherwise than out of an act of the character just described is destroyed by the National Banking Act, then all set-offs are destroyed; the prohibition, resting merely upon implication, must be general, and affect that right in its entirety. No distinction can be drawn between set-offs confirmed by express language of statute, and those confirmed by the usage of courts of equity. Indeed in Ohio, as has already been said, and probably in all the other states that have adopted the modern code of civil procedure, the right of equitable set-off is confirmed by statute, and has as much statutory warrant as what is known as a legal set-off; Rev. Stat. of Ohio, secs. 5071, 4993, (*ante*, pp. 6, 7). Every right of set-off, legal or equitable, is but a right to a certain redress recognized in the law as existing; they differ only in the procedure by which they are enforced. If we accept the limitation on the right of equitable set-off asserted in New York and Pennsylvania—that it has no complete existence until the claim sought to be set off has matured, then the two rights, legal and equitable, are identical in their nature, in that when they exist at all, they exist as causes of action, capable of being enforced at once by suit; and it will hardly be contended that the National Banking Act contemplates the destruction of one of these causes of action, and the preservation of the other. If on the other hand we take the broader view of equitable set-off which has always met the approval of this court, then the equitable right is none the less existing before the maturity of either claim, although the time for its enforcement by judicial proceedings may not have arrived; it is nothing more nor less than the right to require in the future the doing of a certain thing by way of specific performance; it is as immaterial in this case, as in any other, that the time for performance has not arrived.

In fine, the National Banking Act, in its provisions as to liqui-

dating and distributing the assets of insolvent banks, does not destroy any *right*, legal or equitable, which had vested at the time of the suspension of the bank, except those growing out of the transfers, assignments and deposits, and the processes before judgment, specifically forbidden by sec. 5242.

The whole argument in favor of the proposition that the doctrine of set-off has no application, or but a limited one, in the winding up of an insolvent national bank, rests, in the last analysis, upon the requirement of sec. 5236, that the comptroller shall make *ratable dividends* among the creditors; in substance the argument is, that to allow the set-off is to pay certain creditors in full, and not to divide the assets ratably.

But here the argument begs the question. It assumes that the entire claim against which the set-off is to be allowed, is *assets* at the time the receiver is appointed; and therein lies the error; the amount so to be set off is not assets of the insolvent bank; it has already been appropriated, in contemplation of law, toward the discharge of the opposing claim; whether the appropriation has in fact been made is immaterial; the right to require it to be made either then or thereafter, has arisen as against the insolvent bank, and the receiver can liquidate the claim only subject to that right. The only part of the claim due the bank that is assets, is the balance, if any, after deducting set-offs recognized in law or equity at the time to which the appointment of the receiver relates; to this balance only does the requirement for *pro rata* distribution apply, and it can not be reduced by setting off rights against the bank acquired by its debtor after the trust for its general creditors became fixed,—following the same line of demarcation already established both in equity and bankruptcy. The development of the doctrine of set-off in the administration of the bankruptcy act of 13 Eliz., c. 7, confirms this view. As we have already said, that statute contained no provision in any way directing a set-off or the striking of a balance. The first statute of that nature was the temporary act of 4 Anne, c. 17 (*anno*, 1705), which provided in sec. 11, that where mutual credit had been given between the bankrupt and another, and the accounts were unbalanced, the commissioners in bankruptcy (the name for the

official now commonly called the assignee), should adjust the account, and take from the debtor of the bankrupt on such adjustment only the balance in discharge. The act of 13 Eliz., c. 7, merely provided, in sec. 2, that the commissioners in bankruptcy were to seize and appraise the lands, moneys, goods, chattels, wares, merchandise, and debts of the bankrupt, sell the lands and chattels, "or otherwise to order the same for the satisfaction and payment of the said creditors; that is to say, *to every of the said creditors a portion, rate and rate alike*, according to the quantity of his or their debts."

The language, it will be observed, is similar to, and if any thing stronger than that of sec. 5236, in requiring the assets to be ratably divided among the creditors. And yet the earliest reported decisions regarding the doctrine of set-off, are cases where it was allowed under this statute of 13 Elizabeth prior to the passage of the statute of 4 Anne, upon the ground of mutual credit, and it is unquestionable that this was the settled course of admininistration under that statute.

This being part of the history of the doctrine of set-off, it having been long ago judicially declared that a provision for a ratable dividend did not preclude the application of that doctrine, it is incredible that congress intended to prohibit or in any way curtail it by such a provision.

The only reported cases we have observed in which the effect of the statutory provisions as to winding up insolvent national banks upon the doctrine of set-off has been considered or involved, are the following, which we name in the order of their decision:

(1867) *Venango Nat'l Bk.* v. *Taylor*, 56 Pa. St. 14;
(1872) *Platt* v. *Bentley*, 11 Am. Law Reg., N. S. 171;
(1878) *Hade* v. *Mc Vay*, 31 Ohio St. 231;
(1883) *Balch* v. *Wilson*, 25 Minn. 299;
(1888) *Balbach* v. *Frelinghuysen*, 15 Fed. 675;
(1888) *U. S. Bung M'fg Co.* v. *Armstrong*, 34 Fed. 94;
(1888) *Armstrong* v. *Scott*, 36 Fed. 63 (the case at bar);
(1888) *Snyder Sons Co.* v. *Armstrong*, 37 Fed. 18;
(1889) *Stephens* v. *Schuchmann*, 32 Mo. App. 333;
(1889) *Armstrong* v. *Warner*, 21 Weekly Law Bull. 136;

(1889) *Armstrong* v. *Second Nat'l Ba[illegible]*, 38 Fed. 883;
(1889) *Tehan* v. *First Nat. Bank*, 39 Fed. 577;
(1891) *Armstrong* v. *Law*, 27 Weekly Law Bull. 100;
(1892) *Yardley* v. *Clothier*, 49 Fed. 337;
(1892) *Armstrong* v. *Warner*, 27 Weekly Law Bull. 330.

A review of these decisions may not be inappropriate.

In *Venango Nat. Bank* v. *Taylor*, 56 Pa. St. 14, it appeared that on April 14, 1865, Taylor became indebted to the Venango National Bank upon a bond, with power of attorney to confess judgment, for $65,000, secured by $31,000 U. S. bonds as collateral. In June, 1865, the bank sold the bonds for $32,000, with the understanding it was to credit their proceeds on the bond, but did not do so. On March 27, 1866, the bank suspended payment. On the next day Taylor became by assignment the owner of the deposit account of Rynd in the bank, amounting to $43,743.45; and afterwards on that day judgment was entered by the bank against Taylor under its warrant of attorney, for the full amount of the bond. On May 1, 1866, this judgment was opened up, and Taylor let in to defend. On May 8, 1866, a receiver to wind up the bank was appointed by the comptroller of the currency. Taylor sought, by way of defense against his bond to the bank, to off-set the proceeds of his collateral, and also the claim which he had purchased from Rynd. The former off-set was allowed and the latter refused. The gist of the decision, therefore, is that the material point of time in ascertaining the rights of the parties is the date of suspension, not that of the appointment of the receiver; claims of set-off depending on dealings between the claimant and the bank before its suspension were allowed; but claims resting upon an assignment to the claimant by a third person after the suspension were disallowed.

Platt v. *Bentley*, 11 Am. Law. Reg., N. S. 171, is a decision by Judge J. F. Barnard in Special Term of the Supreme Court of New York. Platt was appointed receiver of the Farmers & Citizens' National Bank, and took charge on September 5, 1887. At that time Bentley had $571.27 on deposit in the bank, and was also indebted to it upon his note for $800, to mature

November 5, 1867. Suit having been brought upon the note after its maturity by Platt as receiver, Bentley pleaded the balance due him upon the deposit account as a set-off; and the set-off was sustained, the court saying in substance that it was good under the decisions in New York, and there was nothing in the national banking act to introduce a new principle.

Hade v. *McVay*, 31 Ohio St. 231, was an attempt by a debtor of a national bank, when sued by its receiver, to set off penalties accruing to him for usurious interest under sec. 30 of the national banking act of 1864 (Rev. Stat., sec. 5198). The court, while of opinion that the receiver "succeeds only to the rights of the bank existing at the time it goes into liquidation," and so was subject to the plea of set-off, held the claim was not available as a set-off, because not arising upon contract within the meaning of the Ohio Statute.

Balch v. *Wilson*, 25 Minn. 299, was an action by a receiver against Wilson and Kimball upon their joint note held by the bank, which matured before its insolvency; the defendants attempted to set off the liability of the bank as indorser (the maker being insolvent), upon certain promissory notes held by Kimball when the bank failed, he having since transferred half of his interest therein to Wilson; these notes did not fall due till after the receiver had brought his suit. The two sets of obligations arose out of totally distinct transactions. The set-off was disallowed. The court held the rights of all parties as to the bank became fixed by its insolvency and passage into the hands of the receiver; at that time but one of the defendants was a creditor of the bank, while they were jointly its debtors; and there was no connection between the claims so as to give rise to the supposition of mutual credit in spite of this diversity of parties.

Balbach v. *Frelinghuysen*, 15 Fed. 675, was a suit in equity by debtors of the bank to compel a set-off. It appeared that the bank had discounted two notes of complainants, both of which fell due after the bank had suspended and the receiver had been appointed; and against these notes they sought to set off the balance due them upon their deposit account. The court (Nixon, J.) said:

"It is unquestionably true that if the Newark Bank held these notes at the time of the failure, and was entitled to receive the amounts due thereon when they matured, such offset might be made. But the evidence is clear that at that date the notes were not the property of the Newark Bank, but had been indorsed away for value."

United States Bung Mfg. Co. v. *Armstrong*, 34 Fed. 94, so far as appears by the report, was an attempt by a creditor of the Fidelity National Bank to recover money voluntarily paid to the receiver upon a note due the bank, so that it might apply the debt thus revived, by way of set-off, to the amount the bank owed it The attempt failed, the court (Jackson, J.) saying the bill "discloses nothing more than the existence of cross-demands or independent debts, which could have been set-off at law, if complainant had asserted its right to do so at the proper time, and in the proper mode. Having voluntarily waived or abandoned this legal right and remedy by paying the note to avoid being sued thereon, it presents no case for equitable relief by way of set-off under the authorities." This opinion, apparently, recognizes the right of set-off in a case of mutual credit where claimed, before payment, in a suit by the receiver upon the indebtedness due the bank. The claim was so made in the error case at bar; the obligations in question fell under the strictest definition of "mutual credits," being a note upon one side, and the proceeds of its discount on the other. And yet the district judge (Sage), in refusing the set-off, says his conclusions are concurred in by the circuit judge (Jackson) as being in accord with the latter's opinion in the case just cited (see Record, p. 13, and *Armstrong* v. *Scott*, 36 Fed. 63). For this reason, we have thought it proper to give from the record of the case decided by Judge Jackson a fuller statement of the facts there in question; they were as follows:

The Bung Company issued to Josiah Kirby its note to his order for $1,300.09, dated March 10, 1887, and payable four months after date (July 10–13), at the First National Bank of Brooklyn, N. Y. The Fidelity National Bank, prior to its suspension, had discounted this note for Kirby, the payee, and had indorsed it for collection to the Chemical National Bank of New York; and the latter

bank indorsed the note for collection to the First National Bank of Brooklyn. When the Fidelity National Bank failed, it owed the Bung Company $1,800, the balance of a deposit account. At maturity, the note was protested for non-payment. Afterward, on July 19, 1887, it was paid by the Bung Company, under threat of suit; and the sum so paid thereafter came into the possession of Armstrong, as receiver of the Fidelity National Bank. The Bung Company filed its bill in equity against Armstrong, as receiver, setting forth the above facts, and praying that he be required to repay to plaintiff what it had paid out in taking up the note, with interest, and to charge the deposit account with the amount due upon the note on the day it was paid. The defendant demurred, and the demurrer was sustained, the opinion filed being that reported *ubi supra.*

It is obvious that there was no similarity between the facts in that case and in the one at bar. There the Fidelity National Bank did not discount the note for the person claiming the set-off; here it did: there the proceeds of the discount did not go into the deposit account sought to be set off; here they did: there the Fidelity Bank did not have the legal title to the note when it suspended payment; here it did: there the note was voluntarily paid, with full knowledge of the facts, and without demanding a set-off; here it was not.

With the opinion expressed in that case we have no dissent; on the contrary, it declares and rests upon what we understand to be well-settled and established principles of law. But by what process of reasoning the judge who delivered that opinion, one of the most learned and able of those now gracing the bench, was able to say, as he did, that it was in accord with the conclusions in the opinion given in the case at bar, and, therefore, to concur therein, we have never been able to understand.

While the error case at bar was held under consideration by Judge Sage, another case involving the right of set-off under the national banking act was argued before Judge Hammond, of the Western District of Tennessee, while he was sitting in the Southern District of Ohio, under assignment to assist Judge Sage. In this case, *Snyder's Sons Co.* v. *Armstrong*, 37 Fed. 18, it ap-

peared that the plaintiff, when the Fidelity Bank suspended payment on June 21, 1887, had there on deposit $2,828.29; previously that bank had discounted for the plaintiff its eleven notes, each for $5,000, maturing at intervals from July to October, 1887. Supposing that these notes were all still held by the bank, the plaintiff arranged with Armstrong, as receiver of the bank, that the deposit should be credited on the note last maturing; and the two notes first maturing were paid. Then it was discovered that the other nine notes had been disposed of by the bank before its suspension, apparently to innocent holders, and the plaintiff was required to pay them also. The plaintiff, therefore, filed its bill in equity for relief against this payment made under mistake of fact, and reinstatement in its rights, by having the amount due it upon its deposit account paid to it by the receiver. Judge Hammond, being informed that Judge Sage then held the case at bar under consideration, held the case under advisement until Judge Sage's opinion had been filed; then being unable to concur in that opinion, and unwilling, therefore, to follow it, but thinking it unseemly that the result in two similar causes pending in the same circuit court should vary because the judges differed as to the law, Judge Hammond set aside the submission to him, so that the judges regularly assigned to the circuit might make such disposition of the case as they thought just. The result has been that further proceedings in that case were stayed, awaiting the decision of this court in this.

In announcing the determination to which he had come, Judge Hammond stated fully, and with masterly ability, the reasons for his dissent from his colleagues, and why, in his judgment, the national banking act did not limit or affect the doctrine of set-off as otherwise applicable to the administration of the estates of insolvents.

Stephens v. *Schuchmann*, 32 Mo. App. 333, was decided by the St. Louis Court of Appeals on November 13, 1888. The facts are not clearly stated, but enough appears to show that Stephens, as receiver of the Fifth National Bank of St. Louis, sued Schuchmann, as maker, and Soderer, as indorser, upon two notes held by the bank, which had not matured when

it failed. Schuchmann seems to have made no defense. Soderer pleaded a general deposit which was to *his* credit in the bank at the time of its failure. The court below allowed this set-off in favor of *both* defendants, and gave judgment in favor of the plaintiff for the excess only of the notes over the deposit. This was reversed, and the cause remanded with instructions to render judgment in favor of the plaintiff against both defendants for the full amount of the notes. There is nothing in the opinion to show that Schuchmann was not in equity primarily bound to pay the notes, as his position as maker would imply; and if such was his liability, the judgment in his favor below was of course erroneous; he as principal could not set off a liability due his surety. But the Court of Appeals did not rest its conclusion upon that reason, but the broader one that the national banking act abrogates the right of equitable set-off, citing and relying upon the decision of Judge Sage in the case at bar; it calls attention, however, to the fact that at the time the bank failed, as the notes were not then due, Soderer's liability as indorser was but contingent, not fixed and absolute, and cites sundry New York decisions to show that for this reason he had no right of set-off, aside from the provisions of the national banking act. As it has since been decided by the Supreme Court of Missouri, *Huse* v. *Ames*, 104 Mo. 91, that under the law of that state, where the maker of a note makes an assignment for creditors before its maturity, an accommodation indorser who subsequently pays the note can not use that payment as a set-off against a debt owing by him to the maker, it is possible that the judgment entered by the Court of Appeals was correct; but the construction given by it to the national banking act was, we submit, erroneous. The case, moreover, is distinguishable on its facts, in that here the maker of the note was liable as surety only, and the indorser—whose claim was to be set off—was primarily liable upon the note.

Armstrong v. *Warner*, 21 Weekly Law Bulletin, 136, arose out of the failure of the Fidelity Bank, and was decided by the general term of the Superior Court of Cincinnati. The case began in the court at special term by a petition by Warner against Armstrong as receiver of the Fidelity Bank, seeking in two causes of

action to compel a set-off; and decree entered allowing each set-off; the general term was asked to reverse that decree. The facts were in brief as follows: First cause of action—On the day preceding the failure of the Fidelity Bank, Warner deposited with it his check on a bank in Rochester, N. Y., receiving in return its draft on a New York city bank. The Fidelity Bank suspended before either instrument was presented for payment, and Warner stopped payment on his check, and now sought to set off the draft against it. Second cause of action—The Fidelity National Bank prior to its suspension had discounted for Gordon's benefit a bill of exchange drawn by Gordon, and accepted by Warner for Gordon's accommodation; the bill matured after the suspension of the bank, and passed into the hands of Armstrong, its receiver; when the bank suspended it owed Gordon on a general deposit account a balance less than the amount of the bill; thereafter Gordon became insolvent. Warner sought to set off the balance due Gordon against the bill of exchange. The opinion of the general term was announced by Judge Taft, and affirms the right of set-off as to each cause of action; it shows that thoroughness of examination and consideration which is so marked a characteristic of the writer, and with which this court must be familiar from his arguments when recently solicitor-general, and demonstrates, we submit, that the opinion of Judge Sage in the case at bar is unsound.

This cause was taken on error to the Supreme Court of Ohio, where, on May 10, 1892, the decision below was affirmed. At the time of present writing, the opinion in the case has not been made public; should it be accessible before this brief leaves the hands of the printer, we shall add a reference to it; meantime we insert here the syllabus as found in 27 Weekly Law Bulletin, 330, that having, under a rule long standing in the Supreme Court of Ohio (46 Ohio St., p. ix, rule VI), been approved before publication by all the judges concurring. It will be seen to be conclusive that the set-off sought here is granted by the jurisprudence of Ohio, and cogent that it is not forbidden by the national banking act. That syllabus is as follows:

"1. When the holder of a claim, not yet due, becomes insolvent, and transfers the same before maturity, and the debtor at the time of the transfer holds a similar claim, then due, against the assignor, his right of set-off is preserved against the assignee, when the latter's cause of action arises. And a surety on the obligation so transferred may enforce the set-off for his own protection, if the principal debtor be insolvent.

"2. Equity will, in general, enforce the right of set-off, by decreasing [*sic*] the compensation of mutual demands so far as they equal each other, where they have grown out of the same or connected transactions, or the one has formed, in whole or in part, the consideration of the other, and the party against whom the set-off is asserted is insolvent.

"3. Section 5242 of the Revised Statutes of the United States prohibits any national bank, when insolvent, or in contemplation of insolvency, from so disposing of its assets as to prevent their proper application to the redemption of its circulating notes, and the ratable distribution of the remainder among its creditors. But it does not prohibit the allowance of any valid set-off, legal or equitable, which a debtor of the bank may have against any obligation owing by him to it at the time of its insolvency.

"4. The allowance of such set-off is not the creation of a preference by the bank, but an ascertainment merely of the just amount due on the debtor's obligation, and may be enforced against a receiver of the bank. It is the balance due after deducting the set-off, which constitutes assets in the receiver's hands for disposition in accordance with the provisions of the federal statutes.

"5. A national bank received on deposit a check drawn by the plaintiff on another bank, and carried the amount to the credit of his agent, upon the agreement that he would take for part of the sum a draft drawn on a distant bank, and would not immediately check out the balance. The draft was accordingly issued, but, before presentment, the drawer (bank), which was insolvent, passed into the hands of a receiver, without having provided any funds with which to pay the draft. The check (payment of which had been stopped) came to the possession of the receiver, and the draft belonged to the plaintiff.

"*Held*, the plaintiff is entitled in equity to have the amount of the draft set off against his liability on the check.

"6. The same bank, at the time of its insolvency, held a draft which it had discounted for and carried the proceeds to the credit

of the drawer, for whose accommodation it had been accepted by the plaintiff. The draft was protested for non-payment, and the liability of the drawer made absolute. As between the drawer and the plaintiff, the former was the principal debtor, and the latter his surety only. When the bank passed into the control of the receiver, the drawer of the draft, who afterward became insolvent, had standing to his credit, on his deposit account with the bank, a sum less than the amount of the draft.

"*Held*, the plaintiff, as surety, is entitled in equity to have set off against his liability as acceptor of the draft the amount due his principal on the deposit account with the bank.

"Judgment affrmed."

Armstrong v. *Second Nat. Bank*, 38 Fed. 883, also grew out of the failure of the Fidelity Bank, and was decided by Judge Sage on May 20, 1889. The facts, in brief, were that the Second National Bank of Springfield had been in the habit of making collections for the Fidelity Bank, and cashing checks drawn upon that bank, rendering statements and monthly balances from time to time. On the day preceding the failure of the Fidelity Bank, two checks upon it, drawn against a sufficient deposit, were cashed by the Second National Bank, and were not presented for payment at the Fidelity Bank till shortly after its doors were closed the next day. Armstrong, as receiver, having sued the Second National Bank for the amount of its collections, it sought to avail itself in defense of those two checks, either as payments or as a counter-claim. Judge Sage held there was no payment for reasons not necessary to detail; and, as to the counter-claim, that the point was covered by his previous decision in the case now under review.

Tehan v. *First Nat. Bank*, 39 Fed. 577, was decided by Judge Coxe, in the Circuit Court for the Northern District of New York. Tehan had brought suit in a state court against the bank and its receiver, appointed by the comptroller, to compel a set-off of certain sums due from the bank when it suspended, to him as administrator of Eliza Tehan upon certificates of deposit, and to him individually upon a deposit account, against notes made by him individually, and other notes on which he was liable as administrator of the same estate, then held by the bank—whether as matured or unmatured does not appear, but presumably the latter.

The defendants removed the case to the federal court "on the ground that a federal question was involved, it being contended that Rev. St. U. S., secs. 5234, 5236, 5242, were drawn in question." The plaintiff moved to remand, and Judge Coxe granted the motion, saying, in concluding his opinion:

"The nature of the action is the same as if the defendant Hayes were the receiver of a state bank, or of an individual. The action involves a simple question of set-off, and is not one arising under the laws of the United States."

Armstrong v. *Law*, 27 Weekly Law Bulletin, 100, was decided by the general term of the Superior Court of Cincinnati. When the Fidelity Bank suspended, Law was indebted to it upon a matured note; he had claims against it for money paid in in advance for void shares of stock issued afterwards without any authority in law (see *Winters* v. *Armstrong*, 37 Fed. 512), and also for a small balance on deposit. Law brought suit to set off the reciprocal claims. The Superior Court, following its decision in the Warner case, allowed the set-off. The case is now pending on error in the Supreme Court of Ohio, leave to that effect having been granted by that court.

Yardley v. *Clothier*, 49 Fed. 337,* grew out of the failure of the Keystone National Bank of Philadelphia, and was before the Circuit Court for the Eastern District of Pennsylvania. When the bank failed, it owed Clother $1,127.96, and held notes indorsed by him, not then due, aggregating $390. Yardley as receiver having sued Clothier upon the notes, the latter sought to set off the debt owing him. The set-off was allowed. The opinion, which was delivered by Butler, D. J., and concurred in by Acheson, C. J., reviews many of the cases we have cited, and some others we have not thought it material to mention, and, refusing to follow the opinions given in the case at bar, and in *Stephens* v. *Schuchmann*, 32 Mo. App. 333, declares there is nothing in the national banking act forbidding the set-off sought. Two passages from that opinion we beg leave to quote:

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* See Addendum, *post*, p. 45.

Page 338: "The doctrine of set-off is founded on the principles of equity, and, within certain limits, is universally recognized and applied. Where parties dealing together become mutually indebted, the balance is, generally, alone recoverable. Well defined and easy of comprehension as the doctrine is, however, its application to the varying state of facts which arise, is attended with the same degree of difficulty that attends the administration of other plain legal principles, under unusual circumstances. In the distribution of insolvent assets—whether under voluntary trusts for creditors, insolvent laws, in bankruptcy, or proceedings on decedents' estates—its application has frequently been resisted on the ground that its allowance would create a preference among creditors. To enter upon an examination of the questions thus raised, and the distinctions drawn would be unprofitable. It is sufficient to say that in every instance in which this objection has been made, (in the absence of controlling statutory provisions,) where the proposed set-off *was* due when the creditors'," *i. e.*, the general creditors', "rights attached, the courts have overruled it—whether the defendant's debt, in suit, was due at the time or matured subsequently."

Again on page 339, after having alluded to Rev. Stat., secs. 5234, 5236, and 5242, the court continues:

"There is, of course, no room to doubt that congress contemplated the equal distribution of assets, without preference, among creditors, just as the assets of all insolvent concerns and individuals, are distributed. If, therefore, allowance of the set-off proposed here would result in such preference, it is prohibited; not more especially, however, by the statute than by the general rule of law applicable to all similar cases. But as we have already seen, it will not. The defendant will receive only what he is legally entitled to. His right of set-off was perfect before the creditors' rights attached. The latter stand in no higher plane than the bank occupied. Even an assignee for value would have taken the note subject to this defense. That the bank might have defeated it by indorsement, is immaterial. That results from considerations not involved here. If the note had matured when the insolvency occurred it would not be pretended that the set-off would confer a preference—that the defendant should pay his debt, as other debtors are required to do, and take a dividend on his credit, as other creditors must. And yet the circumstance that it was not due is obviously immaterial to the equities involved."

Before leaving this branch of the subject we should call attention to the opinion of Judge Sage in *In re Armstrong*, 41 Fed. 381, announced January 18, 1890; for although it does not allude in terms to the doctrine of set-off, yet it seems to us that the relief there granted rested, at bottom, upon the same equities as set-off, and that this opinion is so radically inconsistent with that in the case at bar, that the two can not both be law. The Seventh National Bank of Philadelphia, apparently having in its hands for collection paper belonging to the Fidelity National Bank, promised on June 20, 1887, to pay a draft of the Fidelity National Bank on it for $15,000; the next day the Fidelity Bank suspended payment; on the day following the Seventh Bank having notice of the failure of the Fidelity Bank, paid the draft and charged the same on its books to the Fidelity Bank; making this charge showed the Fidelity Bank indebted to the Seventh Bank in $7,384.25. Afterwards the Seventh Bank collected $7,257.28 on the paper belonging to the Fidelity Bank, and claimed to hold the same on account of the balance due it.

The receiver presented the matter to the court on an application for leave to compromise. Judge Sage said that the promise to pay the draft was equivalent to an acceptance, and that the acceptance gave the acceptor a lien from that date upon the funds and securities in his hands belonging to the drawer to meet the subsequent payment of the draft, and finding that the Seventh Bank, when it promised to pay the draft, had no intimation of the impending failure of the Fidelity Bank, he concluded:

"Upon this state of fact this court is of opinion that the transaction was not within the inhibition of section 5242, Rev. St. U. S., and that the Seventh National Bank had the right to apply the proceeds of the collection upon the paper in its hands of the Fidelity Bank, at the date of the acceptance, to the payment of the draft. An order will be made accordingly."

We submit that the weight of authority, as expressed in judicial opinion, is against the doctrine announced by the court below, in 36 Fed. 63, and in accord with our contention that the national banking act contains no limitation, express or implied,

upon the doctrine of set-off as ordinarily applied by courts of law or equity in matters arising in the settlement of estates of insolvents, and that under that doctrine the State Bank as principal debtor, and *a fortiori* Scott as security, could insist that the balance due to the State Bank on its deposit account should be set off against the amount due upon the note, from the discount of which that balance arose.

The Set-Off a Defense at Law.

It will probably be urged that even if the right of set-off existed, yet it was purely equitable in its nature, and so could not be pleaded successfully in an action at law pending in a circuit court of the United States; hence that the *judgment* of the court below in the case on error was correct, though the *reasons* assigned for it were erroneous. And it may further be claimed that this has been practically admitted by us in filing the bill in equity. Such latter claim, however, would be immaterial, even if well founded, as the rights of parties must be determined by the *law*, and not by the admissions of counsel or parties relating thereto. But as a matter of fact the claim is not well founded; the intention in filing the bill in equity was not to abandon seeking redress in law, but to prevent further delay and bring about a speedier decision upon the merits, should this court decide a court of law was not the proper forum.

The court below did not question its jurisdiction or power, sitting as a court of law, to adjudge a set-off on the facts pleaded, but merely denied that such facts constituted a set-off in any court. In *Yardley* v. *Clothier*, 49 Fed. 337, where a contrary conclusion was reached, the right to grant relief at law does not seem to have been questioned. And we contend that such right exists.

Unaided by statute, the Circuit Court, sitting as a court of law, could not have entertained a plea of set-off at all. Its powers in that regard, by reason of the conformity act—Rev. Stat. of U. S., sec. 914—are limited by the statutes of Ohio. That its sphere of action extends to all phases of set-off permissible under those statutes, it is not necessary for us to urge; it is sufficient if we show

that action on the facts here pleaded was not beyond the proper scope of the duties of a court of law.

The primary idea of the early English statutes of set-off was mutual debts, liquidated demands, between the parties to the record, in the same capacities in which they there appeared. The plaintiff must always have been in privity of contract with the defendant either by direct contract between them, or by substitution by assignment passing the legal title to the chose in action sued upon; and *per contra*, ordinarily the like privity must support the counter-action of set-off; that is, the plaintiff must have been obligor, and the defendant obligee or his assignee at law. And yet even here there seem to have been exceptions, attributable to the court having power in the particular case to look through the shell of form, and see the kernel of substance within; thus there were certain contracts made by an agent, upon which either agent or principal might sue in his own name; if the suit were brought by the agent to inure to the principal's benefit, a debt of the principal might be set off, *Jarvis* v. *Chapple*, 2 Chitty, 387; *Coppin* v. *Craig*, 7 Taunt. 243; and if the suit were brought by the principal, the debt of the agent might be set off, provided it accrued before the defendant discovered he was dealing with an agent, *George* v. *Clagett*, 7 Term, 359; Evans on Agency, 469. But from the difficulty the courts of law had ordinarily in seeing more than the rights *inter sese* of the parties *nominally* before them, it resulted that generally when the plaintiff of record was not the beneficial owner of the claim, a set-off against that beneficial owner could be had only in equity; and further that as debts of the plaintiff of record might be set off, though not owing by the beneficial owner, the latter also might have to resort to equity for his own protection.

The courts of law in this country struggled to avoid the strict rules of the earlier statutes as applied to their procedure, and to sustain or refuse set off, where either of the claims, which it was attempted to oppose to the other, was not still held by the original owner. *Vide*, *Holland* v. *Makepeace*, 8 Mass. 418; *O'Callaghan* v. *Sawyer*, 5 Johns. 118; *Miner* v. *Hoyt*, 4 Hill, 193. And in several states statutes were enacted by which the equitable rule of beneficial ownership, rather than the former statutory rule of legal title,

was made to a greater or less extent the index for courts of law in administering the remedy of set-off.

In Ohio a different course was adopted. In that state there are no longer any courts sitting simply as courts of law, nor any statutes addressed peculiarly to such courts. The code of civil procedure abolishes the distinction in form between actions at law and suits in equity, requires all actions (with a few specified exceptions, sec. 4995) to be brought in the name of the real party in interest, and permits all defenses, whether formerly known as legal or equitable, to be made therein; Ohio Rev. Stat., secs. 4971, 4993, 5071 (*ante*, pp. 6, 7). It follows that an assignee of a chose in action sues in his own name. There is no express declaration that choses in action are now assignable, so as to pass the legal title, and it is debatable, to say the least, whether the *rule of law* in that respect is changed. If it has been changed it follows that the assignee could sue in his own name in the federal courts; but as he takes his title subject to defenses good against his assignor (Rev. Stat. of Ohio, sec. 4993, *ante*, p. 6), we submit that so far as those defenses would be available at law to the defendant as against the assignor, he may use them at law against the assignee; this seems to be laid down by this court, speaking by Mr. Justice Matthews, in *Pritchard* v. *Norton*, 106 U. S. 133, *ad finem;* and was a necessary ground of the decision in *Stewart* v. *Anderson*, 6 Cranch, 203. Upon the other hand, if the legal title is not transferred by an assignment, and it should follow as a consequence that the assignee, suing at law, must sue in the name of his assignor, he should be subject in such suit to the set-off of claims against himself which are enforceable at law; he should also be subject to set-off of claims against his assignor, enforceable at law when the suit is brought, provided they arose before the assignment, and were recognized thereafter as a good set-off either at law or in equity; but he should not be subject to set-off of other demands against his assignor.

These consequences follow from the abandonment in the Ohio statute as to set-off of the former requirement of mutuality of debts as between the parties to the record, and substituting in its stead mutuality of debts as between the true parties in in-

terest. They must be adopted by the federal courts so that their procedure may, as required by U. S. Rev. Stat., sec. 914, "conform as near as may be" to that of the state courts of record. No principle of the common law would be violated; on the contrary, the procedure there permitted as to set off in cases where the court was allowed to open its eyes and see the real interests of the parties, as illustrated by the English agency cases to which we have referred, and some of the state statutes of set off, is followed. No cause of action of purely equitable cognizance would be enforced at law; such would remain still within the domain of equity; to that court it would be left, as before, to decree a set-off for equitable reasons where the claim asserted by the defendant had never been strictly mutual with that asserted against him, where the same persons, and those only, had not been reciprocally debtor and creditor.

But while this discussion of the subject in its general aspect has seemed pertinent, the facts in the case at bar do not require an inquiry into and decision of all the questions suggested by such discussion. Indeed, the goal we seek may be reached by another path, which practically avoids a solution of how far a federal court of law can enforce the equitable principles of set-off introduced into the modern codes of procedure.

It will be observed that while the note in question was indorsed payable to the order of the Fidelity Bank, it was never indorsed by that bank (Record in Error Case, p. 2); hence Armstrong never got legal title thereto by the law merchant. There was no voluntary assignment to him; hence even if the statutes of Ohio make all choses in action assignable, so as to transfer the legal title, he got no title from that source. Nor did he get title by operation of law, for the national banking act does not operate to transfer the *title* of the bank's assets to the receiver. By that act, sec. 5234, it is provided that he "shall take possession of the books, records, and assets of every description of such association, collect all debts, dues, and claims belonging to it, and, upon the order of a court of record of competent jurisdiction, may sell or compound all bad or doubtful debts; and, on a like order, may sell all the real and personal property of such association, on such

terms as the court shall direct;" but all this he is to do "under the direction of the Comptroller;" and he must "pay over all money so made to the Treasurer of the United States, subject to the order of the Comptroller." And all disbursements from this fund, whether for expenses of the receivership or payment of claims, are to be made by the Comptroller, secs. 5236, 5238. The receiver is not a trustee clothed with the legal title to enable him to execute a trust; he is merely a liquidating agent, like a sheriff, a marshal, a master commissioner, or any other receiver. Nor is the Comptroller such a trustee; he is merely a disbursing agent. Nor is the Treasurer of the United States such a trustee; he is merely a depositary to keep the money as realized. The proceedings in liquidation do not disturb, or in any way affect, the legal title to the property of the bank; that remains after the appointment of the receiver the same as before. True, the receiver may sue in his own name to collect the assets of the bank; but this is because he is an officer of the United States, charged with the duty of converting those assets into money, not because he has the legal title thereto; instead of suing in his own name, he may sue in the name of the bank, which would be impossible if the bank no longer had title.

Kennedy v. *Gibson*, 8 Wall. 498.
Bank of Bethel v. *Pahquioque Bank*, 14 Wall. 383.
Bank v. *Kennedy*, 17 Wall. 19.
Platt v. *Beach*, 2 Ben. 303.
Price v. *Abbott*, 17 Fed. 506.
Chemical Bank v. *Bailey*, 12 Blatch. 480.

It is true that in *Kennedy* v. *Gibson*, 8 Wall. 506, it is said "the receiver is the statutory assignee of the association;" but it is manifest that by that phrase the court intended merely to point out, by an apt simile, the general character of the duties of the receiver, and not to imply that there had been by force of the statute an assignment to him either at law or in equity of the assets of the bank by force of the statute; for the statement is followed by the assertion that all suits "may be brought both at law or in equity, in his name, or in the name of the association, for his use;"

if the legal title were in him, he certainly could not sue at law in the name of the association; and if the equitable title were in him, it is difficult to see how he could sue in equity in that name. Indeed, the exact question was decided by this court, though not with reference to this consequence, in *Rosenblatt* v. *Johnson*, 104 U. S. 462, where it is said, speaking of the title to assets of a national bank:

"Such property and assets, in legal contemplation, still belong to the bank, though in the hands of a receiver, to be administered under the law."

Thus the title to the note remained in the Fidelity Bank, with power in the receiver to collect the note by action at law in his own name or in the name of the bank.

Had he brought suit in the name of the bank, the power of the court in that case to hear and allow the set-off could not be questioned; there would be the mutuality of the debts between the parties of record, even as required by the English statutes as to set off; there would be the maturity of both demands when the suit was brought, as also required by those statutes; no assignment having been made, the "two demands must," in the language of the Ohio statute, sec. 5077, *ante*, p. 7, "be deemed compensated, so far as they equal each other," and the court would have so adjudged.

We can see no reason why a different result should be reached when the receiver sues in his own name instead of that of the bank. He sues in that way, not because of any personal interest or ownership in the note, but because he has statutory power so to do. But the existence of such power, and the option it gives him as to the form his proceedings shall take, surely can not enable him to put fetters upon the court, and deprive it of the power to do speedy justice to the defendants.

We have not overlooked the fact, appearing in the record in the equity case, that the charter of the Fidelity Bank was forfeited after the receiver was appointed, and before he brought suit upon the note; and that by such forfeiture the existence of the bank was terminated, and the legal title to its assets necessarily trans-

ferred, as declared by this court in *National Bank* v. *Colby*, 21 Wall. 609. But no such fact appears in the record of the law case; all that there appears is that Armstrong has been appointed receiver of that bank, and is engaged as such in winding up its affairs (Rec., p. 1); and this alone does not work its dissolution, *Bank of Bethel* v. *Pahquioque Bank*, 14 Wall. 383; *Rosenblatt* v. *Johnston*, 104 U. S. 462. Whether or not there was error in the law case, must be determined by the facts appearing on *its* record, not on those appearing elsewhere.

But even if such dissolution had appeared in the record, or could be judicially noticed by the court, there was error in disallowing the set-off, for the reasons urged above with reference to the effect of the conformity act.

To conclude this branch of the argument, it was decided by this court in *Partridge* v. *Insurance Co.*, 15 Wall. 573, before the passage of R. S. of U. S., sec. 914, that a defendant in a federal court could avail himself of a set-off as he could in a state court. Though the matter is somewhat complicated in Ohio by the abolition of the distinction between proceedings at law and in equity, yet, aside from the code, it has been common legislative practice to permit certain pleas of set-off, usually considered equitable in their nature, to be made at law; and particularly is this true in matters affecting insolvent estates; and courts of law have found no practical difficulty in adjudicating set-offs depending upon mutual credit, whether or not either or both of the demands were due when the assignment of the insolvent's assets was made; witness *Atkinson* v. *Elliott*, 7 Term, 378, and numerous other cases under the English bankruptcy acts; *Receivers* v. *Paterson Gas Light Co.*, 3 Zabr. 283; *Colt* v. *Brown*, 12 Gray, 233. If there was no assignment of the legal title to the note from the bank to the receiver, a strictly statutory right of set-off arose at its maturity under Ohio Rev. Stat., sec. 5077, which could unquestionably have been pleaded at law had the suit been in the name of the bank as plaintiff of record, and which could have been defeated only by a showing of equitable grounds which do not exist in this case, such as that the claim set off was acquired after the insolvency with knowledge thereof; and this right to

plead the set-off at law can not be taken away by suing in the name of the receiver. If the legal title to the note was assigned to the receiver, yet it was assigned subject to an equity of setting off a debt of the assignor which courts of law, either by express permission of statute, or by a permission implied from analogy to other statutes, have for many years been in the habit of enforcing; had the statutes of Ohio contained an express power to courts of law to entertain such a plea of equitable set-off, no one could doubt the right of the federal courts to exercise the same powers at law; the fact that Ohio has no courts of law pure and simple, but addresses all its statutory provisions to courts of justice, without distinction between procedure at law and in equity, does not preclude the federal courts in Ohio from entertaining actions and defenses provided for by those statutes, if tney be such as in jurisdictions maintaining the distinction between procedure at law and in equity are intrusted by statute to the custody of courts of law, or such in their nature as to be readily enforced by a court of law.

For these reasons, we submit the Circuit Court erred in the action at law in sustaining the demurrer to the amended answer of the State Bank, and in entering judgment against it for the full amount due upon the note.

And as it is conceded that the State Bank was principal, and Scott but a surety upon the note, it follows there was error as to him also; where the principal and surety are sued together, judgment can not be taken against the surety for a greater sum than against the principal.

Failure at Law no bar in Equity.

If, however, we are wrong in the argument just urged, if the Circuit Court, sitting as a court of law, had no power to grant the set-off prayed, it follows necessarily that its judgment is not a bar to a subsequent suit in equity to secure the allowance of the set-off upon the same state of facts. Inability of the law to grant relief is the source and origin of equity jurisprudence; and failure to procure a set-off at law because the set-off was equitable in its nature, is no bar to obtaining subsequent relief in equity. Whatever the

form of the judgment at law, it is an adjudication merely that the facts pleaded are no defense at law, not that they are no ground for relief in equity. Upon the latter question the court at law has no jurisdiction to pass, and should it attempt to do so, its judgment would simply be void for want of jurisdiction. Freeman on Judgments, sec. 281.

Judgment at Law, if Erroneous, yet is no Bar.

Furthermore, if the facts pleaded at law did constitute a set-off available at law, so that the judgment denying the set-off was erroneous, yet that judgment is no bar to the bill in equity subsequently filed.

It will be observed, first, that the judgment at law was on demurrer; and, secondly, that additional facts were pleaded in the bill in equity which were not stated in the answer at law, viz.: an understanding when the loan was negotiated, that the balance of the deposit account, when the note matured, was to be credited thereon; and also fraud by the Fidelity Bank, in that it was insolvent when the loan was made, note taken, and proceeds deposited, but concealed these facts from the State Bank.

As to the effect of the judgment on the demurrer, this court in *Gould* v. *Evansville R. R. Co.*, 91 U. S. 526, after stating that a judgment for defendant upon a demurrer to the declaration is a bar against further litigation upon the same statement of facts, adds, p. 534:

"But it is equally well settled, that, if the plaintiff fails on demurrer in his first action from the omission of an essential allegation in his declaration which is fully supplied in the second suit, the judgment in the first suit is no bar to the second, although the respective actions were instituted to enforce the same right; for the reason that the merits of the cause, as disclosed in the second declaration were not heard and decided in the first action."

And the principle is again stated in *Wiggins Ferry Co.* v. *O. & M. Railway*, 142 U. S. 396. Other authorities are collected in the notes to sec. 267 of Freeman on Judgments.

A plea of set-off or counterclaim is but a cross action, *Higgins* v. *McCrea*, 116 U. S. 671, 683; and a judgment sustaining a de-

murrer thereto has the same effect as one sustaining a demurrer to a declaration. It is not a bar to a subsequent suit either at law or in equity, where the merits are more fully disclosed.

If therefore the new and additional matters alleged in the bill in equity, in connection with the other matters therein stated which had been previously pleaded at law, show a state of facts upon which equity would have decreed a set-off, or granted other relief as against the note, prior to the judgment at law, that judgment is no bar to the granting of such relief. *Johnson* v. *Christian*, 128 U. S. 374.

That the understanding contemporaneous with the loan, that the balance due upon the deposit account at the maturity of the note should be applied as a credit thereon, and the retaining by the Fidelity Bank of the proceeds of the discount on deposit, the officer acting for it knowing it to be insolvent and the other party being ignorant of that fact, were severally, and *a fortiori* conjointly, grounds for relief in equity by way of setting off the deposit against the note, and this although the bank had passed into the hands of a receiver before the note matured, seems to us so clear upon principle, and so well settled by the authorities already cited, that full discussion of the proposition is needless.

The understanding was in itself an agreement for a set-off, or *stoppage* as it used to be called, and a sufficient ground for relief by specific performance as declared in *Jeffs* v. *Wood*, 2 P. Wms. 128, and in 2 Story's Equity, sec. 1435, where, speaking of bonds payable at different times, it is said:

"If in such case there should be an agreement to set off the debts against each other, *pro tanto*, there could be no doubt, that a court of equity would enforce a specific performance of the agreement, although, at common law, the party might be remediless."

We have already cited sundry cases to the effect that the discounting of a note in bank and leaving the proceeds there on deposit secures to the depositor the right to set off the balance of the deposit account when the bank suspends payment before the note matures. We add the following where the same relief was

given to the bank under circumstances similar except that it was the depositor that became insolvent.

Camden Nat. Bank v. *Green*, 45 N. J. Eq., 546; affirmed on this opinion in 46 N. J. Eq. 607.

Dougherty Bros. & Co. v. *Central Nat. Bank*, 93 Pa. St. 227.

Shunk v. *Merchants' Nat. Bank*, 16 Weekly Law. Bull. 353; s. c., 19 Chicago Leg. News, 83.

The action of the officer of the Fidelity Bank who, knowing it to be insolvent, made the arrangement with the State Bank, and induced it to leave the proceeds on deposit, was also a fraud upon the State Bank, which of itself gave the latter the right of set-off.

Ex parte *Stephens*, 11 Vesey, 24.

Ex parte *Blagden*, 19 Vesey, 466.

Rothschild v. *Mack*, 115 N. Y. 1.

The case falls within the principle of

St. Louis, etc., Ry. Co. v. *Johnston*, 133 U. S. 566.

Cragie v. *Hadley*, 99 N. Y. 131.

Importers & Traders Nat. Bank v. *Peters*, 123 N. Y. 272.

For while the State Bank may not be able to trace, and so recover *in specie*, the moneys so deposited, yet it can reclaim the note thus obtained from it by fraud upon repaying the amount actually advanced; or, which is the same in substance, though different in form, it can set off against the note fraudulently obtained the balance of the proceeds fraudulently retained.

And as each right grows out of the original transaction in which the note was given, they might be characterized, under sec. 5072 of the Ohio Statutes, as rights of counter-claim, as well as of set-off.

But the essence of the matter is not the name given, but the right itself, in one case that of specific performance, in the other that of rescission—by obtaining a cancellation of the note obtained by fraud upon tendering back the money drawn from the deposit account; each of them being grounds for equitable relief from the

time the note was given, and available against every one who was not a *bona fide* purchaser thereof for value.

We submit, therefore, that in the case pending on error the judgment should be reversed, and the cause remanded for further proceedings; and in the case pending on certificate, in responding to the questions certified for decision, the first, second, fourth, and seventh should be answered in the affirmative, and the third, fifth, and sixth in the negative.

Wm. Worthington

J. W. WARRINGTON,

Of Counsel for Plaintiffs in Error and Appellants.

ADDENDUM.

The decision in Yardley *v.* Clothier, 49 Fed. 337, referred to *ante* p. 30, has been affirmed by the U. S. Circuit Court of Appeals, Third Circuit, Dallas, C. J., and Wales and Green, D. JJ., sitting. The opinion has been published in 51 Fed. 506, while this brief was in the printers' hands. From it we quote as follows:

P. 507. "The rule of set-off is well understood to be that in all cases of mutual credit only the balance that shall appear to be due upon an adjudication of the mutual accounts should be paid, and it is that balance only which is the debt and is recoverable; that mutual obligations for the payment of money cancel each other; and that the death or insolvency of either party will make no difference in the adjustment of their mutual accounts. This rule may be modified by exceptional circumstances, or by statute, but is generally applied as here stated. The allowance of set-off has been frequently objected to in the distribution of insolvents' assets and in the settlement of decedents' estates for the reason that it would create preferences among creditors, but the controlling weight of authority has established the doctrine that, in the absence of express statutory prohibition, a set-off of a debt owing to the defendant will be allowed if it was due when the creditor's rights attached, whether the debt sued on was due at the same time or matured subsequently."

P. 509. "So far as this question has been passed upon by the federal courts, the decision in *Armstrong* v. *Scott* stands alone, and it deserves no support from the cases referred to in the opinion of the court by which it was rendered."

P. 510. "The statute was designed to prevent fraudulent transfers of assets and payments of money made by the bank with a view to prevent the application of the assets in the manner prescribed, or with a view to the preference of one creditor to another; but the allowance of the set-off of the defendant's deposit would not be a violation of the statute under any fair and reasonable construction of its provisions. The application of the rule that mutual accounts are to be adjusted in such manner that only the balance constitutes the debt to be recovered is, as has been seen, established by a long line of judicial precedents, and is not forbidden by the language or the meaning of the national banking act."

J. W. WARRINGTON,
Of Counsel.

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JAMES H. McKENNEY,
CLERK.

Supreme Court of the United Stat

OCTOBER TERM, 1892.

Levi Scott et al.
Plaintiff's in Error.

v.

David Armstrong, Receiver, etc
Defendant in Error.

Farmers' and Merchants' State Bank et al.
Appellants.

v.

David Armstrong as Receiver, etc.
Appellee.

BRIEF FOR DEFENDANT IN ERROR AND APPEL

J. W. HERRON,
Defendant
Counsel for Plaintiff in Error and A

SUPREME COURT OF THE UNITED STATES.

LEVI SCOTT, and THE FARMERS' and MERCHANTS' STATE BANK, Plaintiffs in Error,

v.

DAVID ARMSTRONG, Receiver of the Fidelity National Bank of Cincinnati Ohio, Defendant in Error.

Error to Circuit Court for Southern District of Ohio, Western Division.

THE FARMERS' and MERCHANTS' STATE BANK and LEVI SCOTT

v.

DAVID ARMSTRONG, as Receiver of the Fidelity National Bank of Cincinnati, Ohio.

On Certificate from U. S. Circuit Court of Appeals for the Sixth Circuit.

BRIEF FOR DEFENDANT IN ERROR AND APPELLEE.

The issues in these cases involve no questions of fact. Both were decided upon demurrers to the petition in the one case, and to the bill in the other.

The question in the cases is whether upon the facts stated in the pleadings the court below erred in refusing to allow the set-off claimed by the defendants below in the first, and by the complainant below in the second case.

The Fidelity National Bank of Cincinnati was incorporated under the national banking laws of the United States, and doing business in the city of Cincinnati. On the 21st day of June 1887, its assets were taken possession of by the comptroller of the currency, and on the

27th of the same month David Armstrong was appointed by said comptroller receiver of the said bank, and immediately took possession of its assets. On the 12th day of July, 1887, the charter of the Fidelity National Bank was forfeited by decree of the Circuit Court of the United States for the Southern District of Ohio.

On the 6th day of June, 1887, The Farmers' and Merchants' State Bank of Fairmount, Indiana, applied to the Fidelity National Bank for a loan of $10,000. This application was granted. The Fidelity Bank discounted the note of Levi Scott, who was cashier of the borrowing bank, made to the order of, and endorsed by that bank, dated June 6, 1887, and payable ninety days after date at the Fidelity Bank.

The proceeds of this discount were placed to the credit of the State Bank on the books of the Fidelity Bank, subject to its checks or drafts. Part of such proceeds had been checked out, and the balance remained to its credit when the Fidelity Bank failed.

The note passed into the hands of Armstrong, as receiver. It matured on the 7th day of September, 1887, and not being paid, suit was brought upon it by said receiver against both maker and endorser in the Circuit Court of the United States for the Southern District of Ohio, in case No. 4067.

The answers of both defendants in that case set forth that Scott was a mere accommodation maker; that the State Bank was the real principal debtor; that the Fidelity Bank was indebted to it on the balance standing to its credit on its books, and claimed to set off such balance to that much of the note sued on, and offered to pay the balance. A demurrer was filed to these answers, which was sustained by the court, and a judgment rendered against the defendants for the full amount of the note and interest.

No transactions between the parties to these suits appear by the pleadings to have existed, except this loan of $10,000 represented by the note sued upon, and the deposit of the proceeds to the credit of the borrowing bank.

Two questions will be considered by me in the discussion of these cases.

1. Whether in either of the cases now pending in this court the State Bank would ordinarily have a right to a judgment authorizing

it to set off the deposit against the claim of the receiver on the note.

2. How far, if at all, the National Banking Act qualifies any right of set-off which may be applicable to bankrupts other than national banks.

I.

As to the Right of Set-off.

It is not every cross-demand or independent debt that entitles a party to a set-off.

Justice Story states the rule very clearly in Sec. 1435, vol. 2, p. 768, Equity Jurisprudence:

"In the first place it would seem that independently of the statutes of set-off, courts of equity in virtue of their general jurisdiction are accustomed to grant relief in all cases where, although there are mutual and independent debts, yet there is a mutual credit between the parties founded at the time upon the existence of some debt due by the crediting party to the other. By mutual credit, in the sense in which the terms are here used, we are to understand a knowledge on both sides of an existing debt due to one, founded on, and trusting to, such debt as a means of discharging it."

And in *Gray* v. *Rollo*, 18 Wall. 632, Justice Bradley says:

"Nor does the case present one of mutual credit. There was no connection between the claims whatever, except the accidental one of the complainant being concerned in both. The insurance company, as far as appears, took the notes without any reference to the policy of insurance, and Gray Brothers insured with the company without any reference to the notes. Neither transaction was entered into in consequence of, or in reliance on, the other. And no agreement was ever made between the parties that the one claim should stand against the other. There being neither mutual debts nor mutual credits, the case does not come within the terms of the bankrupt law. If it can be maintained at all, it must be upon some general principle of equity, recognized by courts of equity in cases of set-off, which if it exist, may be considered as applicable under an equitable construction of the act. But we can find no such principle recognized by the courts of equity in England, or this country, unless in some exceptional cases which can not be considered as establishing a general rule."

In the case of *The U. S. Bung Mfg. Co.* v. *Armstrong*, 34 Fed. Rep. 94, the question arose upon a set-off claimed against a note discounted by the Fidelity National Bank and not due at the time of the appointment of the receiver. The case was identical with the present one, the set-off being a deposit account. Judge Jackson, in deciding that case, clearly held that the deposit account did not constitute a valid set-off. He says:

"It is well settled that the mere existence of cross-demands, or independent debts, does not create any right to an equitable set-off. There must exist a mutual credit between the parties, founded at the time upon the existence of some debt due by the crediting party to the other. * * * Mutual credits such as would give rise to an equitable set-off apply only to that class of cases where there has been mutual trust or understanding that an existing debt should be discharged by a credit given upon the ground of such debt."

The counsel for the defendant treat the present case as coming within the rule thus laid down so positively as to require no argument, and yet, I submit, it is wholly without that rule.

There was no knowledge on either side "of an existing debt due to one, founded on and trusting to such debt as a means of discharging it." It is true that the deposit resulted from the discount of the note in controversy; but that did not change the character of the deposit unless connected with an agreement that it could be used as a set-off to the note. The transaction negatives in the strongest manner any such knowledge or intention. The parties did not occupy the relation usual between bankers and their depositors, where one party deposits a sum in a bank, and borrows money from that bank, and when this loan is due pays it by checks on the money so deposited. The State Bank borrowed this money not to let it lie in the Fidelity Bank, but to be used by it in its own business. It paid a discount upon the entire amount, for the entire time the note had to run. It is idle to say that after paying this discount it intended that the money or any part of it should remain in the bank until the maturity of the note, to be used in the payment of that note. The fact that it did not use the entire sum at once does not affect this conclusion. There was no intention on the part of the bank to pay this note in whole or in part

by this deposit. Such an idea is wholly inconsistent with the facts connected with the discount of the note. Nor had the Fidelity Bank any right to retain in whole or in part this deposit as security for the note. The State Bank had the right to check it out as it pleased. And would, undoubtedly, have used the entire sum long before the maturity of the discounted paper, if the Fidelity Bank had not failed at the time at which it did. The answer, it is true, avers that, "The balance * * * was permitted to remain with said Fidelity Bank, to meet a like amount to become due on said note, and that the means of the defendant were being, and have been accumulated, and deposited in said bank to take up and meet the balance on said note at maturity." There is no averment that this intention was the result of the agreement between the parties at the time the paper was discounted, or that the Fidelity Bank had any notice of such intention, or that in any way it was entitled to hold any part of said proceeds for any such purpose. The averment is inconsistent with the previous averment that the deposit remained in the Fidelity Bank subject to the checks or drafts of the State Bank, as it might see fit to use it. And the averment about the accumulating and depositing in the Fidelity Bank to meet this note is fully negatived by the averment that the balance in the Fidelity Bank at the date of its failure was the exact balance of the proceeds of the note not at that time checked out. No deposit of any kind except such proceeds was made by the State Bank in the Fidelity Bank, nor one dollar accumulated there for the purpose of paying the note in question.

The deposit, then, had no connection with the payment of the note. It was not suffered to remain in the Fidelity Bank for that purpose. The Fidelity Bank had no lien on it for the security of the note, nor any expectation of using it for the payment of it. The State Bank had no deposit account in the Fidelity Bank, such as ordinary depositors have, which was increased and diminished from time to time as its business required, and from which deposit account it would naturally have paid the note when due. It had no other account with the Fidelity Bank except this single transaction. The negotiable note held by the Fidelity Bank, and the deposit account owing to the State Bank were wholly independent claims, and were not the subject of set-off within the definition laid down by Justice Story, or the decision of this

court, or of the Circuit Court of the United States for this district, already quoted.

II.

The second question, and the one principally relied on in the present case, is whether the National Banking Act modifies in any respect, and if so how far, any right of set-off which might on principles of law or equity be applicable in the case of other classes of insolvents?

I do not claim that no cross demand can in any case be allowed by the court in the case of the insolvency of national banks.

In the case of a current account existing between a national bank and another, the balance of the account due at the time of the act of insolvency only can be collected. In such a case both sides of the account constitute but one account, and the excess of the larger over the smaller side of that account is the sum actually due between the parties.

Where the debtor bank has on the faith of its indebtedness accepted or agreed to accept a draft drawn on that indebtedness, so as to render it liable to the holder of that draft, it may deduct the amount of that draft from the account; not entirely on the doctrine of set-off, but as a payment made on the account. The agreement to pay the draft out of that fund is treated the same as if it had actually been paid. This was the case in *Armstrong* v. *Seventh National Bank of Phila.*, 38 Fed. Rep. 883.

An agreement to sell bonds of the debtor, and to credit the proceeds on the note of that debtor held by the bank, will be enforced when the bank holding the paper has received and sold such bonds, and not made the credit. This was the case in *The Venango Bank* v. *Taylor*, 56 Penn St. R. 14.

In this case Justice Strong allowed the credit, not as a set-off but because there had been an understanding that the proceeds of such sale should be applied on the debt.

Where the note held by the insolvent bank is past due at the time of the insolvency, and it, at the same time held a deposit account of the debtor on the note, also due, a set-off will probably be allowed. In such cases set-off legally applies, and the bank has the right to charge the past due paper to the account, and the debtor ought to have

given his check for the amount due him to pay such note in whole or part; no injury in such a case is done to the general creditors.

But where a national bank at the time of an act of insolvency, holds a discounted note not due, and the debtor has in the same bank a deposit account not placed there on account of, or to meet that note, which the bank can not take or hold for its debt, the national banking law as I claim prohibits the receiver from receiving the deposit as payment in whole or in part of the note. He must hold the note in trust for the general creditors, including the debtor, to collect it and divide the proceeds ratably among them.

Sec. 5234, R. S., among other things, provides: "Such receiver under the direction of the comptroller, shall take possession of the books, records, and assets of every description of such association; collect all debts due and claims belonging to it, and upon the order of a court of record, of competent jurisdiction may sell or compound all bad or doubtful debts, and on a like order may sell all the real and personal property of such association on such terms as the court shall direct. * * * Such receiver shall pay over all moneys so made to the treasurer of the United States subject to the order of the comptroller, and also make reports to the comptroller of all his acts and proceedings."

Sec. 5236 provides: "From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the comptroller shall make a ratable dividend of the moneys so paid over to him by such receiver, on all of such demands as may have been proved to his satisfaction, or adjudicated in a court of competent jurisdiction, and as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated."

Sec. 5242 provides: "All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor all deposits of money, bullion, or other valuable thing for its use, or for the use of any of its shareholders or creditors, and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application

of its assets in the manner prescribed in this chapter, or with the view to a preference of one creditor to another, except in payment of its circulating notes, shall be utterly null and void."

The object of these provisions has been clearly stated by this court in several cases.

In *National Bank* v. *Colby*, 21 Wall. 613, Justice Field says:

"There is in these provisions a clear manifestation of a design on the part of congress: 1. To secure the government for the payment of the note, not only by requiring in advance of their issue a deposit of bonds of the United States, but by giving to the government a first lien for any deficiency that may arise on all the assets subsequently acquired by the insolvent bank. And, 2. To secure the assets of the bank for ratable distribution among the general creditors."

And, again:

"That the object of sec. 5242 (52) is to secure this equality among the general creditors."

In *Pacific National Bank* v. *Mixter*, 124 U. S. 725, Chief Justice Waite, after quoting sec. 5242, says:

"This was evidently intended to preserve to the United States that first and paramount lien * * * and to place all the other creditors on that equality in the distribution of the assets of an insolvent bank which was clearly provided for in sec. 50 (5236), where the comptroller of the currency is required to make ratable dividends of the proceeds of the assets of the association, realized by the receiver on all such claims as have been proved to his satisfaction, or adjudicated in a court of competent jurisdiction."

And in *Venango Bank* v. *Taylor*, 52 Penn. St., R. 16, Justice Strong says:

"This section (52) is too plain to be misunderstood; read in connection with the 50th, it admits of no doubt that the purpose of congress was to secure all the assets of the bank existing at the time of its act of insolvency for ratable distribution."

I need not argue further to this court that the great object of the sections quoted was to secure to the general creditors of an insolvent bank a ratable distribution of all its assets existing at the time of its act of insolvency.

It is further settled by this court that every one dealing with a national bank can obtain only such rights against such bank as are authorized by the act of congress.

In *National Bank* v. *Colby*, Justice Field again says:

"The act of congress prescribed the conditions upon which national banks shall be created, the powers they shall possess, and the consequences of their failure to meet their obligations. All persons dealing with these institutions can only acquire and enforce rights against them under the limitations there designated."

And Justice Strong, in *Venango Bank* v. *Taylor*, says:

"The bank is a creature of the act, dependent upon it for all its powers, and controlled by all the restrictions which the act imposes, and creditors dealing with the bank, can obtain only such rights as it is authorized to give."

It will be noticed that both of these decisions are made upon a similar question to that now before this court. It was upon the right of a creditor to obtain preferences from the assets of an insolvent national bank, and, therefore, the language used has direct application to the case now under consideration. If, therefore, the act of congress limits or qualifies any of the legal or equitable rights which the creditors of insolvents ordinarily possess, or, if it is necessary to limit or qualify those rights in order to carry into effect the general intent of congress as expressed in that act, the creditors of national banks, and all persons dealing with them, must submit to such limitations and qualifications, and surrender all legal and equitable rights which they might have enforced had the insolvent been other than a national bank. They can enforce no right however equitable or honest, which they may possess against an insolvent national bank unless the law of congress authorizes them so to do.

Let us now see how far this court has limited or qualified the rights

of creditors when attempted to be enforced against insolvent national banks, and the effect which this court has given to the intent of congress upon this subject.

I will first refer to the case of *National Bank* v. *Colby*, decided by this court in 21 Wall. 609.

In that case, the First National Bank of Selma, Alabama, committed an act of insolvency on April 16, 1867, and on the 30th of April, 1867, a receiver of the bank was appointed. On the 17th of April, 1867, Colby sued out an attachment in the state courts of Alabama against this bank, and caused it to be levied on the real estate of the bank. The receiver afterwards, in the state courts upon allowance, moved to discharge this attachment; which motion was overruled by the court, and judgment rendered in favor of Colby for the amount sued for. The case was then taken by the receiver to the Supreme Court of Alabama, where the judgment of the lower court was affirmed. The Supreme Court of Alabama, in deciding the case, says:

"The act of insolvency does not dissolve its liability to be sued, nor the liability to be sued by attachment. The act of congress does not so declare, nor is it necessary for the purposes of that statute to declare it. By the practice of our courts attachments are only abatable when they have been issued without affidavit, or without bond, as required by law. These being the only causes enumerated, others are excluded by their omission. And matter of abatement can not be given in evidence upon an issue upon the merits, a default, or a failure to plead."

The case was then brought to this court on error from the Supreme Court of Alabama.

It must be remembered that when this action was brought the law of congress did not prohibit attachments against national banks: the amendment of the law, prohibiting such attachments, was passed March 3, 1873.

The right to sue an insolvent debtor, and to attach the property of such insolvent debtor, was fully given by the laws of Alabama; and when such attachment was issued and levied on the property of the debtor, the creditor acquired a lien upon all the property so attached

prior to every other creditor. No assignment had been made; no receiver had been appointed; the property attached remained in the possession of and under the control of the debtor. This right to hold the property of the debtor as security for the debt, was a legal and not a mere equitable one; and was as strong and complete in every respect as any claim of set-off can possibly be. The act of congress did not in language prohibit such attachment, and the Supreme Court of Alabama held that this lien was fully authorized by the laws of the state: that the proceedings were in every respect conducted according to the statutes of the state, and was not prohibited by the acts of congress, and that the attaching creditor had a valid lien on the the property of the debtor, prior to the title of the receiver. It can not be claimed that had there been no law of congress on the subject, the attaching creditor would not by these proceedings have acquired this lien. But this court swept aside every such claim, not on the ground that the law of congress expressly prohibited it, but upon the general intent of congress to distribute equally among the creditors all the assets of an insolvent bank, and that no such lien could be permitted to interfere with that intention.

In deciding the case, Justice Field says:

"As to the general creditors, the act evidently intends to secure equality among them in the division of the proceeds of the property of the bank."

And after quoting the provisions of sections 50 and 52 of the act of congress, as justifying this conclusion, and after stating the design of congress, as before quoted, he says on page 614:

"This design would be defeated if a preference in the application of the assets could be obtained by adversary proceedings. The priority of the United States and the ratable distribution among the general creditors, so studiously provided for in the act, would in that case be lost. As justly observed by counsel, if preference was left to the race of diligence, creditors living remote from the location of the bank would always be distanced in the contest. And the equality promised to them by the act would be a mere mockery."

Diligence is as much a favorite of courts as set-off. But it was not permitted to interfere with the intention of the act of congress.

Again, in the *Pacific Nat. Bank* v. *Mixter*, 124 U. S., 721, this court, Chief Justice Waite delivering the opinion, fully approved the decision in 21 Wall. just referred to, and held that the purpose of congress, after providing for the paramount lien of the United States, was

"To place all the other creditors on that equality in a distribution of the assets of the insolvent bank which was clearly provided for in sec. 50."

And held that the act equally prohibited attachments in the United States Court as in the state courts, although the latter only were mentioned in the act.

Again, I refer to *Venango Nat. Bank* v. *Taylor*, 56 Penn. St., R. 14.

In this case the debtor of an insolvent bank based his defense to a note held by the bank on two claims, which he asked to be credited upon the note. First, the proceeds of $32,000 of bonds received by the bank prior to its failure, under an agreement to credit them on the note; and, second, a deposit claim against the bank, purchased by him after the act of insolvency, but before the appointment of a receiver.

The first claim was allowed by the court. Not as a set-off, though on the claim made in this case he was entitled to it on that ground, but because, as stated by Justice Strong in his opinion, "there had been an understanding that the proceeds of such sale should be applied to the debt due by him, but he was entitled to no other credit."

The right of one party to purchase a claim against another was fully recognized by the laws of Pennsylvania. The debtor in this case became the owner of that claim. He had a full valid claim against the insolvent bank, and it was then due. There was no pretense of any collusion between him and the insolvent bank in that purchase. It was not claimed that the act of congress prohibited such a purchase; but the court refused to allow it not because the debtor was not a *bona fide* holder of a valid claim against the bank, but because to allow it would be to defeat the equal distribution of the assets among the general creditors.

Justice Strong, in deciding this case, says:

"It is plain, if he can use his equitable title to the deposit made by Rynd as a defense against the legal claim of the bank, a preference of one creditor over another is wrought out and secured after the act of insolvency. But this is the very thing which in our opinion the act of congress aimed to prevent. It provides a system for closing the affairs of an insolvent bank, the clear design of which is to place all creditors except the government and note-holders on an equal footing. Its purpose is to disallow preferences of one creditor over another, and it denies the power to make such preference at any time after an act of insolvency."

After quoting sections 50 and 52, he says:

"This section is too plain to be misunderstood. Read in connection with the 50th it admits of no doubt that the purpose of congress was to secure all the assets of the bank at the time of its act of insolvency, for ratable distribution."

And, again:

"It may be conceded, as was insisted in the argument, that there is nothing in the act of congress which declares that the assets of a bank vest in the receiver immediately from and after the act of insolvency, or that the appointment of the receiver relates back to such act. Indeed, at no time does the property in those assets vest in the receiver. The difficulty of the defendant does not lie here; but is found in the prohibition of any transfer or disposition until the appointment of a receiver coupled with the manifest purpose for which the prohibition is made. The bank's property is placed by the act under the immediate potential control of the government. It is noticeable that the first object sought to be secured was the payment of the circulating notes. The money obtained by the receiver, after being paid into the treasury, is to be applied to satisfying the government for the redemption of such notes; and next, to payment of the creditors of the bank, among whom, of course, are included depositors ratably. But this primary object would be defeated if depositors can transfer their deposits to the debtors of the bank, and enable them by set-off to relinquish the debts. By such a process the depositors would secure payment of their claims in preference to the note-holders or the government and ratable distribution among the other creditors than the note-holders be frustrated. It need hardly be said that no con-

struction can be given to the act of congress so directly at war with its spirit."

Here, then, was a claim owned by the debtor against the creditor, which would have been a proper set-off under the arguments of counsel on the other side, rejected by the court simply because to allow it would prevent an equal distribution of the assets of the bank among the general creditors.

Again I refer to *Stevens, Receiver*, v. *Schuehman*, 32 Mo., Ap. 333.

This action was upon notes held by an insolvent national bank not due when the receiver was appointed. The set-off claimed was a general deposit account; and was allowed by the court below. The laws of Missouri fully authorized such a set-off to be deducted in the case like the one before the court, as is stated by the court on pages 336–7 of the decision.

The court, however, holds:

"The act of congress prescribes the conditions for which national banks shall be created, the powers they possess, and consequences of their failure to meet their obligations. In our judgment persons dealing with these institutions can only acquire and enforce rights against them under limitations designated in the act above referred to."

After citing sections 5234 and 5242, the court says:

"It is perfectly clear from this that the act of congress establishing these banks intended first, to secure the government for the payment of the notes, and, second, to secure equality among the creditors of the bank in the division of the property and proceeds thereof. That there should be no preference of one creditor above another, all to share ratably in the proceeds of the association. * * * If the theory of the lower court is correct, then its judgment has the very opposite effect of that clearly intended by the national banking act, *i. e.* In giving the endorser of the note in question credit for the entire amount of his deposit, while the other creditors must be satisfied with just what the assets of the bank will pay, whether it be ten, twenty, or fifty per cent. * * * It defeats the very object of the law, and can not be upheld by any rule of fairness or justice."

I also refer to the opinion of Judge Sage, concurred in by Judge Jackson, in the opinion which is a part of the printed record of the case.

On the other side are the decisions of Judge Hammond in *Snyder's Sons Company* v. *Armstrong*, 37 Fed. Rep. 18, of the Superior Court of Cincinnati, affirmed by the Supreme Court of Ohio, in *Armstrong* v. *Warner*, 21 W. L. B., 136; and of Judge Butler in *Yardly* v. *Clothier*, 49 Fed. Rep. 337, affirmed by the Circuit Court of Appeals of the Third Circuit.

These cases sustain the right of a debtor to set-off a deposit claim against a note not due at the time of the appointment of a receiver.

The case of *Yardly* v. *Clothier*, attempts to dispose of the cases herein cited, by what seems to me to be an entire misapprehension of the law. The court explains the case of the *Venango Bank* v. *Taylor*, by saying:

"The set-off proposed was a claim acquired after the bank became insolvent and closed its doors. This was plainly forbidden not more especially by the statute than by the general rule governing the administration of all insolvent estates."

I submit that this set-off was not plainly forbidden by the statute. It was only forbidden because it interfered with what the court found to be the general intent of the act of congress. Nor was it forbidden by the general law governing the administration of all insolvent estates. It is not illegal to purchase a claim against an insolvent estate, and to use that claim in the payment of a debt to it, unless the assets of the insolvent estate had at the time passed into the hands of an assignee or receiver, or unless the laws of the state regulating the settlement of insolvent estates expressly, or by implication, prohibited it.

The court also disposed of the case of *Bank* v. *Colby*, 21 Wall., by the sentence: "That this (the attachment) was a violation of the statutes is clear." But as I have shown the attachment was not a violation of the statute as it existed at that time. It was only a violation of the statute for the same reason as previously stated in reference to purchasing a claim against the insolvent after the act of insolvency.

The other cases, I think, equally misapprehend the effect of the decisions of this court, and the clear intent of the act of congress.

But the question remains what is meant by the word assets of the bank as it is used in the statute and in the decisions quoted.

Sec. 50 provides that the receiver shall "take possession of its assets, collect its debts, and upon the order of a court of record, sell its real and personal property, and pay over the money into the treasury of the United States, subject to, the order of the comptroller of the currency. * * * The United States shall have a first and paramount lien upon all the assets"

Justice Field says, in *Bank* v. *Colby* on page 613, that the act gives to the government as security for the notes issued "A first lien for any deficiency that may arise on all the assets subsequently acquired by the insolvent bank," *i. e.*, after the circulating notes have been issued. And it secures "the assets of the bank for ratable distribution among the general creditors."

Justice Strong says, in *Venango Bank* v. *Taylor*, that the act "secures all the assets of the bank existing at the time of its act of insolvency for ratable distribution."

The assets to be distributed ratably among the creditors, are the same as those upon which the government has the first and paramount lien, and they include all assets acquired by the bank existing at the time of the act of insolvency.

Sec. 5211, R. S., provides:

"Every association shall make to the comptroller of the currency, not less than five reports each year according to the form which may be prescribed by him, verified by the oath or affirmation of the president or cashier of such association, and attested by the signature of at least three of the directors. Each such report shall exhibit in detail, and under appropriate heads, the resources and liabilities of the association at the close of the bank on any past day by him specified."

These reports are required to be transmitted to the comptroller, and published in a newspaper in the place where the bank is located.

The resources of a bank are its assets. The form prescribed by the comptroller of the currency under this act, as to the details required in stating in such report the resources or assets of the association, is as follows:

On paper, with two or more individual or firm names. ——
On single name paper (one person or firm) without other security..... ——
On mortgages or other real estate security, how acquired?..... ——
On U. S. Bonds (Demand Loans)..... ——
On other stock, bonds, etc., demand loans..... ——
On time, secured by collaterals..... ——

Included in the above are:

Bad debts as defined in sec. 5204, R. S..... ——
On suspended and overdue paper..... ——
Liabilities of directors (individual and firm) as payees. ——
Other stocks, bonds, and mortgages..... ——

What is the object of this statement, and the publication of it in the newspapers as required by law? Evidently to enable those who deal with the banks, its stockholders and depositors, to judge of the responsibility of the bank. To know what security they have when they deposit their money in the bank. When a depositor sees on the one side of this statement the amount and character of its assets, he can form some opinion as to their sufficiency to meet the liabilities of the bank as shown on the other side of the statement. If the assets of the bank which are the security of the general creditors, are entirely different from the amount shown by the statement, if secret set-offs and cross-demands, or contingent liabilities, are permitted to affect their value, this statement becomes a delusion and a snare. But as the act itself requires that the resources or assets so shown are the same as the bills receivable, etc., held by the bank, the same definition should apply to the word when used in the same act, and in the decision of the court in construing that act.

Among the assets of the Fidelity Bank existing at the date of the act of insolvency, was the note for $10,000 in controversy in these cases. It was a negotiable note not yet due. It had no endorsement

or other indication on its face of any payment on it, or other defense to its collection. In that condition it would appear in the published statement of the bank as an asset for the full amount, applicable to the payment of the creditors of the bank.

I can see no difference between the equity of the State Bank and that of other creditors of the Fidelity Bank. The State Bank left the proceeds of its discount in the Fidelity Bank, relying upon the solvency of the latter. So did every other depositor. If it is allowed the set-off as claimed, it will lose nothing by its confidence in the bank, or by permitting the deposit to remain there. Other depositors must take what dividends the comptroller is able to pay them. As I have stated, the bank never expected to use this deposit to pay this note. It was not left there for that purpose, but simply for convenience in checking it out as business required it. There is no more sympathy to be extended toward the State Bank than toward a thousand other depositors who relied upon the published statements of the assets of the Fidelity Bank, and in which was included this note.

It seems to me that the court below was right in holding that the deposit of the State Bank, not being intended for the payment of the note, there was no right of set-off in the suit brought by the receiver, and no equity in favor of the State Bank in its bill filed for equitable relief.

III.

There are certain questions submitted to this court by the Circuit Court of Appeals for its instruction in deciding the equity case brought after the judgment in the case at law which introduced into the case propositions not raised in the latter case.

Interrogatories Nos. 3 and 4, on page 1 of the record in case 1513 of this court, state in this way the defense which had been set up in the case at law:

"And the defense pleaded is a set-off of a balance of the proceeds of such discount left on deposit with such bank, said deposit having been made with the understanding that any balance thereof remaining to the credit of the borrower at the time of the maturity of such note should be then applied as a credit thereon."

To these questions, as thus stated, it may be answered that they involve mere hypothetical propositions not involved whatever in the case. No such defense was pleaded in the answers referred to; and the statement of facts accompanying the interrogatories does not bear out any such defense. There is not a single fact given in that statement from which it may be inferred that there was any understanding of that kind whatever. The answers do not aver any such understanding. They do state that after the deposit had been made the State Bank permitted it to remain there in part to meet said note. As the facts in the case give no foundation for such an interrogatory, I submit that it is entirely outside of the issue in either of the cases before the court. If, however, these questions should be answered by this court, there being an averment in the bill, and the case being decided on a demurrer to the bill, I should desire to have them so answered that if necessary an answer could afterward be filed denying the truth of every such allegation. The decision of this court upon the other question in the case, may fully settle all the matters at issue. But if the decision should depend upon this new question, it would only result in the equity case being reversed by the Circuit Court of Appeals, and remanded to the Circuit Court for further proceeding, and an answer could then be filed denying the allegation. The averments on which these questions are founded, were not noticed by the counsel for the receiver until too late to change the pleadings. The equity case was not argued below, but a decree dismissing it at once submitted to, so that it might be appealed and heard in this court in connection with the other case.

Another question not involved in the answer of the case at law, is stated in interrogatory No. 7; and it arises out of the alleged insolvency of the Fidelity Bank at the time of the discount of the note in question. It is claimed that because the Fidelity Bank was at the time insolvent, and that that fact was known to its officers, but not to the State Bank, this should authorize a set-off even if it could not otherwise be sustained.

The Fidelity bank discounted the paper in controversy. It, as

directed by the borrowing bank, placed the proceeds to its credit. There is no claim that it in any way influenced the borrowing bank to make the discount, or to permit the proceeds to remain in the bank. If there was any negligence or fault in the matter, it lies with the State Bank. It borrowed the money and did not call for it. The Fidelity Bank did everything it was asked, or agreed to do. The deposit was left in the bank by the State Bank in the same manner, and upon the same representation as every other deposit in the Fidelity Bank. It was mixed with the general assets of the estate. There was nothing by which it could be identified. And I know of no greater or higher equity of the State Bank than that of every other creditor by deposit of the Fidelity Bank. All were deceived as to the character of that bank. All have to suffer for their confidence in its solvency. And justice to the other depositors requires that the State Bank shall bear equally with them the result of the mistake.

Again, how shall a different result be reached in the equity case, from that reached in the action at law?

If the defendant below has a legal defense to the action, it must be pleaded in the case at law, and equity will not afterward interfere. Every defense which might have been made in the first must be supposed to have been made, and no defense which could have been pleaded then will afterward be listened to.

I have argued that there was no legal set-off in this case which a court of law could recognize. Will a court of equity go further than the legal rights of the parties authorizes a court of law to do? Equity favors an equal distribution of the assets of an insolvent national bank. Equity grants the same relief to all creditors alike. So far as this deposit is concerned the State Bank stands no higher, has been no more defrauded or injured, than every other depositor has, and is entitled to no higher consideration. That bank should stand or fall upon its legal rights. Equity will not stretch its rules to protect it, to the loss of other creditors. The question here is solely between the general creditors *represented* by the receiver, and the State Bank. It should suffer equally with them. The National Banking Act

recognizes in the strongest language the equity of this equality. This court has fully recognized the justice of that equality.

I submit that the law case, No. 55, should be affirmed by this court, and the questions submitted by the Circuit Court of Appeals answered in such a manner as will authorize the receiver to enforce the judgment rendered in the action at law.

JOHN W. HERRON,
Counsel for ~~Plaintiff~~ Defendant in Error and Appellee.

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Supreme Court of the United States

OCTOBER TERM, 1892.

No. 53.] *Levi Scott et al.*, *Plaintiffs in Error,* vs. *David Armstrong, Receiver, etc.,* *Defendant in Error.*

No. 1025.] *Farmers' and Merchants' State Bank et al.*, *Appellants,* vs. *David Armstrong, as Receiver, etc.,* *Appellee.*

REPLY TO BRIEF FOR DEFENDANT.

J. W. WARRINGTON,
Of Counsel for Plaintiffs and Appellants

Supreme Court of the United States.

OCTOBER TERM, 1892.

Levi Scott et al.
Plaintiffs in Error,

No. 53.] *vs.*

David Armstrong, Receiver, etc.,
Defendant in Error.

Farmers' and Merchants' State Bank et al.,
Appellants,

No. 1025.] *vs.*

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Appellee.

REPLY TO BRIEF FOR DEFENDANT.

The argument on pages 4–5 of the brief for defendant would lead one, not having the record of these cases before him, to suppose there was no causal connection between the discount of the note and the deposit of its proceeds, and that the deposit was simply a matter of convenience to the State Bank, a result of, but having no relation to, the discount. The facts are, however, as appearing in the amended answer of the State Bank (Error Rec., p. 7), and in the statement of facts appended to the questions in the certified case (Appeal Rec., p. 3), that both discount and deposit were merely the method of executing a prior agreement, to make a loan by giving credit upon the books of the Fidelity Bank. The deposit would not have been made were it not for the discount, nor the discount were it not for the deposit. It is

not correct, therefore, to say (Defendant's Brief, p. 5), "the negotiable note held by the Fidelity Bank, and the deposit account owing the State Bank, were wholly independent claims."

The definition of "mutual credit" laid down by Mr. Justice Story, referred to in the passage immediately following that just quoted, is not printed correctly on page 3 nor on page 4 of the brief for defendant, on each of which it is quoted. The mistake is, of course, accidental; but, as it makes the definition (already quoted by us, our brief, p. 10) obscure, and, it seems to us, meaningless, we reprint it, italicizing the words omitted in our adversary's brief:

"By mutual credit, in the sense in which the terms are here used, we are to understand a knowledge on both sides of an existing debt due to one *party, and a credit by the other party*, founded on, and trusting to, such debt as a means of discharging it."

It is said the State Bank's account was not an ordinary deposit account, fluctuating by constant checks and deposits, and that it is idle to say it expected to pay the note from this deposit. That may be, and yet it does not affect the solution. The question is not how did the State Bank expect to pay the note at maturity, but why did it feel safe in leaving the money till needed in the Fidelity Bank. And the answer is the same here, as it would be in case of an active deposit account—because of the existence of the cross-debt, of the relation, in other words, of mutual credit.

But the main reliance of our opponent, as he frankly states, is not so much that a case of set-off is not presented, as that the National Banking Act has destroyed that remedy.

In urging this, however, he must necessarily concede, if only for argument's sake, that the set-off claimed is one that would be allowed were it not for the provisions of that statute; else the set-off would be denied by the general rule of law, and not the special rule of the statute.

His argument is logically inconsistent. He concedes that

the prohibition of the statute is not universal, that certain set-offs can still be allowed, *e. g.*, of claims both of which had matured prior to insolvency, and in cases where there is an express agreement looking toward set-off at maturity (Defendant's Brief, pp. 6–7).

But the only difference between the remedy as to setting off matured claims and that as to others, is that the one is granted by statute, and the other generally by equity.

The National Banking Act makes no discrimination; if it affects the equitable remedy, it must the statutory remedy also.

Again, there is no inherent difference between the right to a set-off resting upon an express agreement, and that resting upon an implied one, or, if you please, a natural equity. If the National Bank Act destroys the one, it destroys the other; and, if it leaves one untouched, so likewise as to the other.

In support of his contention that the allowance of a set-off would be the permission of a preference contrary to the intent of R. S., sec. 5242, our opponent relies on

Venango Bank v. *Taylor*, 56 Pa. St. 14.
Stephens v. *Schuchmann*, 32 Mo. App. 333.
National Bank v. *Colby*, 21 Wall. 609.
Pacific Nat. Bank v. *Mixter*, 124 U. S. 725.

As to the Pennsylvania and Missouri cases, we have already commented upon them. We may add that the former is not opposed to, but in support of our claim, because it enforced the deduction of a credit by reason of an express agreement made between the parties prior to the commission of the act of insolvency which led to the appointment of the receiver; and, as we have stated, an implied statutory prohibition which does not deny a remedy resulting from an agreement, will not deny the same remedy if properly deducible from conduct. Whether the deduction allowed in that case should be called "a set-off," is rather a matter of taste in nomenclature than of substance; it accomplished the same result as a set-off, and was such in effect, whatever it be called.

In *National Bank* v. *Colby*, a suit had been begun by attach-

ment against a national bank *after* the commission of an act of insolvency because of which a receiver was subsequently appointed; the receiver moved in that suit to dissolve the attachment and discharge its levy, and his motions were overruled. The Supreme Court of Alabama held this was not error, because when the suit was begun the bank was suable by attachment, and *in that action* the receiver could represent only the rights of the bank; it did not decide "that the attaching creditor had a valid lien on the property of the debtor, prior to the title of the receiver," as asserted in our opponent's brief, but on the contrary expressly refused to decide that question, as not being before it *in that case;* 46 Ala. 435. This court, however, held that the receiver could and should assert in that case not merely the rights of the bank, but those arising in the government and the general creditors from the act of insolvency, and represented by him; and, holding that the prohibition of preferences with a view to, or after the commission of, an act of insolvency, and the requirement that assets of the insolvent bank should be applied first to redeeming circulating notes, and then to a ratable division among creditors, were an implied denial also of the right to obtain a preference by legal proceedings after the act of insolvency was committed, declared the attachment void. It is obvious that there is nothing in the scope of this decision affecting the case at bar. All that was decided as to the sections of the statute under consideration was that they required the *status* of the assets as they stood when the act of insolvency was committed, to remain unaffected by any liens or claims *thereafter* arising, whether by voluntary act of the bank, or by process of law. Upon the crucial question here involved—what are the assets of the bank which are to be equally divided?—neither the decision, nor the reasoning in support of it, throws any light.

The case of *Pacific National Bank* v. *Mixter*, 124 U. S. 725, is still farther afield. The point decided was that the prohibition against attachments now found in R. S., sec. 5242, is operative upon the federal as well as the state courts, and regardless of the insolvency of the bank.

Our opponent refers also to the requirement of R. S., sec. 5211, for report of resources and liabilities, and says *resources* are *assets*. We submit they are not, in the sense in which the terms are used in secs. 5211 and 5242. A statement of resources and liabilities calls for the gross sums on each side, the gross value of property held, the gross amount of charges or liabilities to be paid. Assets, however, with reference to a division among general creditors, means merely the net value, after settling all liens and offsets prior in right to those of such creditors. In the one case, specific liens are not deducted from the resources, but appear in the liabilities; in the other, such liens are, or should be, deducted, and the balance is assets.

It is suggested by our opponent (his brief, pp. 18, 19) that the third and fourth questions certified to this court in the equity case are impertinent, and need no response; that the answers in the law case contained no averment that the deposit was made with the understanding that its balance on maturity of the note should be applied as a credit thereon; nor does the statement of facts appended to the interrogatories bear out such defense.

It is admitted that the bill in the equity case does contain such an averment; and as the appeal to the court below was from a decree dismissing that bill on demurrer, and the fact is stated in the question upon which that court wants guidance, it would seem a trivial objection that it is not repeated in the statement of facts. The statement of facts required by the rule in such cases is not, we take it, to be a copy of the bill in full, or a repetition of every fact in it, but a condensed statement, sufficient to give the court a general idea of the state of facts upon which the questions arise.

But we do not agree that the understanding in question is not inferentially stated in the statement of facts. On the contrary, we submit that such an understanding is necessarily to be implied from the requirement that the money borrowed should be credited at the Fidelity Bank subject to check.

As to the answer in the law case, it would seem sufficient to say that that answer, in itself, has nothing to do with the equity case in its present stage.

As to the equities of the State Bank, as compared with those of other creditors, the subject has been discussed too often in the cases upon the general question of set-off to render it necessary for us to answer what our opponent says on that head. It is enough to call to mind that over a hundred years ago Lord Mansfield said the assertion of the very right of general creditors for which our opponent contends, as against one in the position of the State Bank, "first shocked the natural sense of mankind" in the administration of the estates of bankrupts; and the inequity in such cases of requiring more than the balance to be paid has led in England to modifications of the statutes of bankrupts, always increasing the right of set-off. Nor is there any known system of insolvency, unless our opponent be right as to the construction of this act, in which the remedy of equitable set-off is curtailed.

Since our original brief was printed, the opinion of the Supreme Court of Ohio, in the case of *Armstrong* v. *Warner* (referred to on pp. 26–29 of our brief), has been published, and will be found in 28 Weekly Law Bulletin, 202. We have already printed in our brief (pp. 28–29) the syllabus of that decision; and for convenient reference by this court we add here the opinion, together with that of the lower court, announced by Judge Taft, whose conclusions were thereby concurred in.

It will be observed that the Supreme Court of Ohio, in its opinion, explicitly approves the opinions of Judge Hammond in *Snyder's Sons Co.* v. *Armstrong*, 37 Fed. 18, and of Judges Butler and Acheson in *Yardley* v. *Clothier*, 49 Fed. 337, referred to on pp. 24–25, and 30–31, of our brief, and disapproves that of Judge Sage in the case at bar.

Wm. Worthington

J. W. WARRINGTON,
Of Counsel for Plaintiffs and Appellants.

[From 21 Weekly Law Bull. 136-140.]

SUPERIOR COURT OF CINCINNATI.

(*General Term.*)

DAVID ARMSTRONG, RECEIVER, *v.* H. H. WARNER.

TAFT, J.

The petition and demurrer thereto raised many questions in equity, which need not be here considered, for the cross-petition for judgment afterward filed by defendant waived many of them, and the action of the court on the evidence finally disposed of all of the others so far as the plaintiff in error is concerned, except the single one of the right of the defendant in error, Warner, to set off against certain obligations of his, held by the Fidelity National Bank, and transferred on its insolvency to Armstrong, its receiver, indebtedness of the bank. There were two causes of action in the petition, and on each the question of set-off arises. The set-offs were allowed by the court below, and this is a proceeding in error to reverse that action.

The bill of exceptions taken by the plaintiff in error, embodies all the evidence. From this, as to the first cause of action, it appears that Warner's check for $4,067, on the bank of Monroe, Rochester, N. Y., was sent to W. J. M. Gordon, of this city, with directions to pay Warner's bill of exchange in New York city, that in pursuance of these instructions, on June 20, 1887, Gordon's clerk took the check indorsed by Gordon to the Fidelity bank for deposit. The receiving teller, knowing that a run upon the bank had greatly reduced the cash on hand, refused to credit Gordon with the amount of the check, lest he might at once draw out the cash on it. Gordon's clerk was referred to Hopkins, the assistant cashier, who told him that the bank could not receive the check as a deposit if he intended to draw cash. The clerk said he wished New York exchange for $3,200. Hopkins said he would give him this. Accordingly the check was deposited, the credit given, and the draft on New York issued to Warner, who sent this draft, with another obtained from another bank, to New York, to take up Warner's paper. The draft was duly presented in New York, but was not paid because the Fidelity had meas-

time closed its doors on June 21, and was taken charge of by the National Bank Examiner. After this Warner stopped payment on his check. Armstrong was appointed receiver June 27, 1887.

Under the decision of the Supreme Court of the United States, in *National Bank* v. *Colby*, 21 Wallace, 609, the paramount lien of the United States, and the lien of the general creditors of the bank, attached at the time of the act of insolvency in keeping the bank's doors closed on June 21, when the National Bank Examiner took charge, and the rights of the receiver, appointed June 27, relate back to that time. Two questions are presented on the record: First, if Armstrong were assignee of a state corporation for the benefit of creditors, the assignment dating from June 21, could the set-off be allowed? And second, if an affirmative answer be given to the first question, do the provisions of the national banking act, especially section 5242, prevent the operation of the state law as to set-offs? Under the first cause of action, neither Warner's liability on the check, nor the Fidelity bank's liability on the draft, had accrued due until after the presentment of each for payment at the respective banks upon which they had been drawn, and a refusal by those banks to pay. Such presentment was made in neither case until after June 21, when the rights of the United States and the creditors vested, and the transfer or assignment to the receiver may be considered as having taken place. The decree of the court below, therefore, amounted to the set-off in favor of a debtor against a debt assigned before due, of a claim against the assignor not due at the time of the assignment. Section 5077, Rev. Stats. of Ohio, provides that, "when cross-demands have existed between persons, under such circumstances that, if one had brought an action against the other, a counter-claim or set-off could have been set off, neither can be deprived of the benefit thereof by the assignment by the other, or by his death, but the two demands must be deemed compensated so far as they equal each other." Now it is evident that this section can not apply to the facts stated because at the time of the transfer to the receiver on June 21, neither Warner nor the bank could have brought an action against the other. In other words, this section has no effect unless both claims to be set-off against each other are due at the time of the assignment. *Fuller* v. *Steiglitz*, 27 Ohio St. 355. If any set-off can be allowed then, it must be what is called an "equitable set-off," *i. e.*, a set-off which a court of equity from equitable considerations will allow, but which a court of law can not recognize.

Equitable set-off is usually said to depend on the existence of a mutual credit between the parties. Mutual credit is defined by Judge Story to be "a knowledge on both sides of an existing debt due to one party, and a credit by the other party founded on and trusting to such debt as a means of discharging it." Eq. Jurisp. § 1435. Now it can not be said in the case at bar, that when Gordon, as Warner's agent, gave the check to the bank and received the draft, that the parties expected that Warner's obligation on the check would be set off against the bank's obligation on the draft, because the nature of the instruments exchanged, being primarily merely orders to pay money, shows that the expectation was that each instrument was to be paid in full by the bank to whom it was directed. The obligations of the drawers on the check and draft were contingent on non-payment by the banks on which they were drawn. It may truly be said that the contingent liability of Warner to pay on the check, was assumed in his behalf by Gordon, on the faith of the bank's contingent liability on the draft, and if the parties contemplated the happening of the contingency of non-payment at all, it may be presumed that they expected these liabilities to offset each other, and that in this sense they were mutual credits within the definition given above.

But we do not think that equitable set-off is confined to cases which come strictly within the foregoing definition of mutual credits. Story says in § 1434 Eq. Jurs.: "If there is a connection between the demands, equity acts upon it and allows a set-off under particular circumstances."

The doctrine of set-off is derived from the doctrine of compensation in the civil law, whereby when cross-demands existed, the two debts were *pro tanto* extinguished by operation of law, and only the balance remained as a debt. Speaking of this doctrine, the master of the rolls in *Whitaker* v. *Busch*, Ambler's Reports, 407, says: "Equity took it up, but with limitations and restrictions, and required that there should be a connection between the demands." A sufficient equitable connection is made between the demands when it appears that one obligation was entered into on the faith of and in consideration of the other. Thus Justice Miller, in *Blount* v. *Windeley*, 5 Otto, 173, says that equity has extended the remedy of set-off so that "*the fact that the mutual obligations have grown out of the same transaction*, and many other purely equitable considerations, have been held to authorize the setting off of many classes of obligations held by the defendant,

against the judgment duly recovered against him in a court of law." If set-offs are allowed against judgments, *a fortiori*, will they be allowed against the claims on such grounds before they have ripened into judgments. So in *Collins* v. *Farquar*, 4 Littell, 154, the Court of Appeals of Kentucky say that equitable set-off will be allowed "in special cases, such as where the matter sought to be discounted forms part of the consideration of the original demand, against which the discount is prayed."

At bar, the draft and the bank's responsibility for its payment, were the consideration for $3,200.00 of the check and Warner's responsibility for its payment. This establishes such a connection between the two as to require an equitable set-off of the draft against the check. The non-payment of the draft gives rise to an equity in favor of Warner against the check, which was inherent in the transaction out of which the liabilities on the check and draft arose, and though this non-payment happened after the vesting of the rights of the United States and the creditors in the check, the equity growing out of it relates back to the original transaction, and must be held to attach to the original liabilities contracted with a view to such non-payment, and so to affect the check in the hands of the receiver.

To look at it in another way, the situation is this: in consideration that the Fidelity agreed that the First National Bank of New York should pay Warner $3,200.00, Warner agreed that the Bank of Monroe should pay the Fidelity $3,200.00. The receiver came into possession of the evidence of Warner's agreement. Is it equitable that he should enforce that agreement when the agreement of the bank is broken? We think not, and we can not see how it affects the question that the evidence of Warner's agreement was transferred to the receiver before the bank's agreement was broken, if by the transfer no rights were conferred on the receiver, which the bank did not then have. Of course, if the receiver is a purchaser for value before due of negotiable paper from the Fidelity bank, different questions arise. But for the present we are considering him only as if he were an assignee for the benefit of creditors under our Ohio laws. And on such an hypothesis we think a set-off would be properly allowed under the first cause of action.

On the second cause of action, it appears that when the bank closed its doors, Gordon had on deposit $1,190.57, and that the bank held a bill of exchange for $4,049.00, due June 24th, upon which Warner was acceptor, and Gordon was drawer. The bill

had been discounted for Gordon's benefit, so that Gordon was the principal debtor, and Warner was surety, as between them. Gordon has, since the closing of the bank, become insolvent. It is conceded by counsel that these facts entitle Warner to the same right to avail himself of Gordon's deposit as a set-off that Gordon would have against the bill of exchange. *Wagner* v. *Stocking*, 22 Ohio St. 297.

The question presented then is, could Gordon set off his deposit against his bill of exchange not due when the bank failed? Such a set-off could not be allowed under the statute, section 5077, quoted above, because when the transfer took place the bank could not have sued Gordon on his bill. Is there then any ground for equitable set-off?

Judge Story, in *Green* v. *Darling*, 5 Mason, 202; in *Howe* v. *Shepard*, 2 Sumner, 410, and in his Equity Jurisprudence, intimates some doubt upon the question whether insolvency alone will justify an equitable set-off of demands which can not be set off at law, and is inclined to think that it will not. Since Judge Story wrote, however, the remedy of set-off in equity has been extended in many states, so that in one class of independent cross demands not compensated at law, insolvency gives rise to a right of equitable set-off. Where A holds an obligation of B which is due, and B holds an obligation of A which is not due, and B assigns A's obligation to an assignee for the benefit of creditors, A is allowed in equity to set off his claim, due before the assignment, against his debt not so due at the assignment. This principle is laid down in the leading case of *Lindsay* v. *Jackson*, 2 Paige, 380, where Chancellor Walworth examines the English cases in chancery, and reaches the conclusion above stated. That was a case where the creditor of an insolvent debtor sought to enjoin his assignee in insolvency from negotiating several promissory notes of the creditor which had not yet fallen due, on the ground that the creditor's claim which was due before the assignment, was a just set-off against the notes, and by negotiation he would be deprived of that right. The injunction was sustained on the ground that, in equity, the insolvency justified the creditor, whose claim was due, in using that to pay his debt before it was due. Exactly the same case was decided the other way in England, in *In re Commercial Bank Corporation of India*, L. R. 1 Ch. Ap. 538, where the court of chancery overruled the vice chancellor who granted such an injunction. See also *Eastern Bk.* v. *Capron*, 22 Conn. 639. But whatever the English view, *Lindsay* v. *Jackson* has been ap-

proved in New York in a great number of cases. See especially *Bradley* v. *Angel*, 3 Comst. 475. The principle has been applied in *Smith* v. *Felton*, 43 N. Y. 419, and in *Smith* v. *Fox*, 48 N. Y. 674. See also *Colt* v. *Brown*, 12 Gray, 233. It is approved in *Receivers* v. *Paterson Gas Light Co.*, 3 Zabriskie, 283, and in *Reppy* v. *Reppy*, 46 Mo. 571. Our own Supreme Court, in *Bank* v. *Hemingray*, 34 Ohio St. 381, approve and follow *Smith* v. *Felton*, 43 N. Y. 419. *Smith* v. *Felton* was a case where a firm had a deposit account with a bank, and the members of the firm were indebted on a note to the bank, the proceeds of which had gone into firm transactions. The bank became insolvent and stopped payment before the note fell due. The firm demanded a set-off of the deposit against the note. In a day or two an assignee took charge, and the set-off was refused. The Court of Appeals held that the set-off should be allowed. In *Skiles* v. *Houston*, 110 Pa. St. 254, A, a banker, died insolvent. At the time of his death B had $760.00 on deposit with him subject to check. Prior to A's death B had a note discounted at A's bank for $850.00, which matured about a week after A's death. Held that a set-off should be allowed. See also *Jordan* v. *Sharlock*, 84 Pa. St. 366; *Smith* v. *Mosby*, 9 Heisk. 501; *Platt* v. *Bentley*, 11 Am. Law Reg. N. S. 171; Morse on Banking, § 338; Pomeroy Remedies and Rights, 163; Waterman on Set-off, § 431. Reference to the cases cited will show that the equitable set-off of a debt due against a debt not due, in case of insolvency is worked out on the theory that the solvent party has the right to have his claim paid at once, and waiving his right to delay the payment of his own debt until it is due, can apply the debt due him to the debt he owes at once.

It has sometimes been questioned whether a deposit can be said to be a debt due until demand for payment or set-off. *Fort* v. *McCully*, 59 Barb. 87. There are some remarks of Judge Folger in *Munger* v. *City of Albany Bank*, 85 N. Y. 580, to this effect, where the deposit is evidenced by a negotiable certificate of deposit in the hands of the depositor. See to the contrary *Seymour* v. *Dunham*, 24 Hun, 93; *Smith* v. *Fox*, 48 N. Y. 674, can not be sustained, however, except on the theory that a simple bank deposit, not evidenced by a negotiable certificate, for the purposes of a set-off, is due at the time the bank stops payment, without demand, and such is clearly the opinion of the Pennsylvania Supreme Court, the New Jersey Supreme Court, the Tennessee Supreme Court, and the Missouri Supreme Court from the cases

cited. It is true that, in this country the statute of limitations does not run on a deposit debt until demand, unless the bank stops payment. Such an event, however, dispenses with the necessity for demand (see Morse on Banking, § 322), so that, at the time the assets vest in the creditors on insolvency, the deposit of each creditor is due, and entitles its owner to use it as a set-off against any debt held by the bank at the time of the transfer, whether due then or not. In the one case his right would be legal, in the other equitable, but none the less to be protected, because the statute law of Ohio recognizes the existence of equitable set-off. Sec. 5076 Rev. Stats.; *Baker* v. *Kinsey*, 41 Ohio St. 409.

This being our conclusion as to the law of Ohio in both causes of action, we now come to the question whether the U. S. statutes as to winding up national banks has taken away this equitable right of set-off. Section 5234 U. S. Rev. Stat., and amendments, provide that the comptroller of the currency may appoint a receiver of a national bank whenever he becomes satisfied of its insolvency, or upon its default in paying its circulating notes. "Such receiver, under direction of the comptroller, shall take possession of the books, records, and assets of every description of such association, collect all debts, dues, and claims belonging to it, and upon order of court may sell or compound bad debts, and may sell the real and personal property of the bank, and may enforce the individual liability of the stockholders. He is to pay over all money so made to the treasurer of the United States, subject to the order of the comptroller. Section 5236 provides that the comptroller after paying any deficiency in redeeming notes of the bank, shall make a ratable dividend of the money so paid over to him on the claims of creditors proven to his satisfaction or adjudicated in a court, and the remainder shall be distributed to the share-holders in proportion to their stock. Section 5242 provides that all transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor; all deposits of money, bullion, or other valuable thing for its use, or for the use of any of its share-holders or creditors, and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, shall be void." It is apparent from reading these sections that a receiver of a

national bank occupies a position analogous to an assignee in insolvency under our state law. In the case of *Hade* v. *McVey*, 31 Ohio St. 231, our Supreme Court expressly say so, and hold that a right of set-off available against a national bank is available against the receiver. It may be conceded that this remark was meant to apply to a case where both debts were due before the transfer, because that was the case the court were considering. The statute of set-off does not execute itself however. The debts remain until by the election of the party one is set off against the other. The effect of the decision in the case cited, then, is that the debt transferred to the receiver has attached to it the right of set-off to be exercised on suit brought at the election of the other party. Now what is the difference in the time the right of set-off attaches between a legal and equitable set-off with reference to the assignment. There can be none. Both attach before the assignment, and the debt passes by the assignment subject to the legal right or the equity of set-off. The right is, therefore, prior to any rights which vest by the assignment or transfer.

Under the first cause of action the equity grew out of the original transaction, and though not developed until after the failure of the bank relates back and affects the check delivered from the beginning. In the second, the equity of set-off attached on the insolvency of the bank, to the bill of exchange. It was by operation of law. It was not by a transfer of any right of the bank in violation of the section quoted.

In *Colt* v. *Brown*, *supra*, the suit was by the receivers of an insolvent bank on a note falling due after their appointment. The maker sought to set off bank bills held by him before the bank had been enjoined from paying any bill, deposit, or other debt, negotiating, assigning, or transferring any security and transacting business except receiving payment in cash of any debt falling due, and also bills bought by him after the issuing of such injunction, but before the appointment of the receiver. Shaw, C. J., deciding the case, says: "The first injunction, having been from time to time continued, and ultimately made perpetual, had the effect of sequestrating and setting apart the assets of the bank as they stood at that time. The defendant having then bills of the bank taken in the course of business to the amount of $1,200, this was an equitable set-off, and the receivers took the estate subject to that equity. To allow any further set-off would be inconsistent with the spirit and intent of the statutes, and would essentially effect a preference in favor of debtors to the bank by en-

abling them to pay in a depreciated medium." And so it will be found that whenever the doctrine of equitable set-off has been enforced against an assignee for the benefit of creditors, it has always had to meet not only the equity of equality among the general creditors but an express statutory direction of equal distribution. In every such case, unless the equity of set-off attached to the debt before passing into the hands of the creditors, it could not have been upheld.

It is claimed, however, that the case of *Venango National Bank* v. *Taylor*, 56 Pa. St. 14, is opposed to this view. An examination of that case shows that the set-off sought to be enforced there was of a claim against the bank purchased by the defendant after the bank had closed its doors. It would, of course, disturb the ratable distribution of the assets of the bank if its debtors could buy up claims against it for the purpose of setting them off. Such a course is denied in *Colt* v. *Brown*, 12 Gray, 233, although in the same case, as has been shown, the view we take of the right of equitable set-off was fully sustained. We are also referred to the decision of Judge Sage, concurred in by Judge Jackson, of the United States Circuit Court, in the case of *Scott* v. *Armstrong*, recently decided, and found in 36 Fed. Rep. 63. The opinion certainly sustains the claim of counsel for the receiver, but highly as we respect the opinion of the judges of that court, we are unable to agree with their conclusion. Judge Sage says: "When the plaintiff was appointed receiver, the defendant was in the list of of unsecured depositors to whom payment, the bank being insolvent, was prohibited. The defendant had then no right of set-off, nor any equity against its note, not then matured, which passed to the receiver. To allow the set-off, now that the note has matured, and thereby make payment in full to the defendant, in part discharge of its obligation to the bank, would be contrary, not only to the policy of the law, but also to the plain meaning of its provisions."

It will be seen that the whole theory of Judge Sage's view rests on the statement that the right which is sought to be enforced against the receiver arises only upon the bringing of the suit. This, we think, the authorities cited show to be erroneous. They could not be sustained, unless the right was an equity attaching before the assignment. Judge Hammond, of the United States Court, dissents from his brethren. See *Snyder's Sons* v. *Armstrong, Rec'r*, 37 Fed. Rep. 18. There is no express provision

in the statute against set-off. And the authorities cited show that the equity of set-off is not defeated by the equity of equality, however stringently and intensely that may be enforced. The decree of the court below is affirmed.

PECK and MOORE, JJ., concur.

KITTREDGE & WILBY, and BURNET & BRUCE, for plaintiff in error; BATEMAN & HARPER, for defendant in error.

[From 28 Weekly Law Bull. 202-207.]

SUPREME COURT OF OHIO.

ARMSTRONG, REC'R, *v.* WARNER ET AL.

ERROR to the Superior Court of Cincinnati.

The original action was brought in the Superior Court of Cincinnati, by Hulbert H. Warner, doing business as H. H. Warner & Co., against David Armstrong, receiver of The Fidelity National Bank of Cincinnati, William J. M. Gordon, and David M. Hyman, trustee for the benefit of Gordon's creditors.

The object of the suit was to establish certain set-offs against obligations which the bank held against Warner. Upon the trial, at special term, the plaintiff obtained judgment allowing the set-offs, which was affirmed at general term, and to reverse those judgments the present proceeding in error is prosecuted by Armstrong, the receiver of the bank. A statement of the facts necessary to a proper understanding of the questions in the case will be found in the opinion.

Joseph Wilby, *W. B. Burnet*, and *Kittridge & Wilby*, for plaintiff in error.

Bateman & Harper, for defendants in error.

WILLIAMS, J.

The general ground upon which the reversal of the judgments below is sought, and the only one advanced by counsel in the argument is, that the facts established by the evidence do not entitle the plaintiff to the set-offs allowed him. The evidence is embodied in a bill of exceptions which was properly taken; and there appears to be neither substantial conflict in the the evidence, nor material controversy about the facts of the case. The facts are substantially as follows: The plaintiff, Warner, was indebted in the sum of $4,067.82, on a draft drawn by him February 19, 1887, on the defendant Gordon, and accepted by the latter for Warner's accommodation, payable four months after date, at

The American Exchange National Bank, New York. On the 18th of June, 1887, being a few days before the maturity of the draft, Warner drew his check on The Bank of Monroe, of Rochester, New York, where he had funds, for $4,067.82, the precise amount of the draft, and forwarded the same to Gordon, to enable him to meet the draft at its maturity. The check was received by Gordon, in Cincinnati, and on the afternoon of June 20, 1887, was presented by him at the counter of The Fidelity National Bank of that city, which declined to cash it, but carried the amount to the credit of Gordon on his deposit account with the bank, upon the agreement that Gordon should accept New York exchange to the amount of $3,200, and the balance should remain to his credit and not be immediately drawn out. Thereupon The National Fidelity Bank, on Gordon's check, issued its draft to him on The First National Bank of New York City, for $3,200, leaving a balance of $867.82 of the Warner check, standing to the credit of Gordon. The Fidelity bank had no funds in The First National Bank of New York City, and when the draft for $3,200 was presented, payment was, on that account, refused; and the draft has since remained in the hands of Gordon and the trustee for the benefit of his creditors. At the time The Fidelity bank received the Warner check, and issued the draft for $3,200, it was insolvent; which fact was known to the managing officers of the bank, and those who transacted the business of Gordon, but was unknown to him. On the same day, and soon after the business with Gordon was completed, the bank closed its doors, ceased to do business, and passed into the hands of a bank examiner. A few days afterward Armstrong was appointed receiver. Warner, upon learning of the failure of the bank, stopped the payment of his check which Gordon had deposited with it as before stated, and the check came to Armstrong's possession upon his appointment as receiver, in which capacity it is now held by him. Gordon, who was in fact the agent of Warner in the transaction referred to with the Fidelity bank, became insolvent shortly after the failure of that bank, and made an assignment of his property in trust for the benefit of his creditors; and the trustee having custody of the draft for $3,200, was made a party to the action below. One of the objects of the plaintiff's action was to have the liability of the bank to him on that draft, issued for his benefit, set off against his liability to the bank on the check for $4,067.82, which Gordon deposited with the bank, under the agreement already stated.

The additional facts peculiar to the other set-off claimed are, in substance, these:

On the 21st of February, 1887, Warner accepted a draft drawn on him by Gordon, for the latter's accommodation, for the sum of $4,249.26, payable to the order of Gordon, four months after date. This acceptance the Fidelity bank discounted for Gordon, and carried the amount to the credit of his deposit account. On its maturity the acceptance was protested for non-payment, and Gordon's liability made absolute. The draft passed into the hands of Armstrong, upon his appointment as receiver, and is still held by him. At the time of the failure of the bank, and the appointment of the receiver, there was a balance due Gordon on his deposit account of $1,190.57, which the plaintiff seeks to have set off against the draft.

The trial court adjudged that the plaintiff was entitled to have the set-offs allowed, but required, as a condition to the entry of the judgment, that he pay the balance remaining due on his obligations in the hands of the receiver, which the record shows was deposited with the clerk, and judgment was accordingly entered. The plaintiff in error resisted the set-offs, as stated by his counsel in their briefs:

"*First.* Upon the ground that Warner's liabilities to the bank not being due at the date of its failure (June 21), the legal or statutory right of offset did not exist; nor did the necessary conditions exist for their allowance as equitable set-offs.

"*Second.* That even if they were allowable as equitable set-offs, yet, being asserted against the assets of a national bank in the hands of a receiver, they could not be allowed without violating section 5242 of the Revised Statutes of the United States."

And it is upon these specific grounds that counsel contend the judgments below should be reversed. We will consider them in the order stated; and while the set-offs allowed do not both stand upon precisely the same footing, they may for convenience be considered together:

1. It is undoubtedly true, that under the statute cross-demands are not "deemed compensated, so far as they equal each other," unless they have existed under such circumstances that if the holder of one of the demands had brought an action upon it against the holder of the other, the latter could have set up his demand by way of set-off or counter-claim; and, as a general rule, to entitle a set-off to be made at law, a present right of action must exist in favor of the holder of each demand against

the other, at the same time; and, consequently, the assignment of one of the demands before it becomes due, will in general defeat the set-off. This was held in *Fuller* v. *Steiglitz*, 27 Ohio St. 355, where there were no equitable considerations for applying the principle of compensation to cross-demands. But, "if an insolvent holder of a claim not yet matured assigns the same before maturity, and the debtor at the time of the transfer holds a similar claim against the assignor, which is then due and payable, his right of set-off against the assignee, when the latter's cause of action arises, is preserved and protected." Pomeroy on Remedies, section 163. This rule, it is said, is based upon considerations of equity, and is adopted to prevent one party from losing his own demand on account of the insolvency of his immediate debtor, and from being at the same time compelled to pay the debt originally owing by himself to the insolvent assignor. It can, of course, have no proper application when the thing transferred is commercial paper, and the assignee becomes the *bona fide* holder thereof for value.

The rule was approved and applied in the case of *Bank* v. *Hemingray*, 34 Ohio St. 381, where the balance due a co-partnership on its deposit account with a banking house which had become insolvent, was set off against the individual notes executed by one of the co-partners to the bank, notwithstanding the notes had been transferred before their maturity, to the assignee of the band for the benefit of its creditors.

Under this rule, the fact that Warner's liability to the Fidelity bank had not matured when it failed, either on the check drawn by him on the Rochester bank for $4,067.82, or on his acceptance of the Gordon draft for $4,249.26, did not, of itself, defeat his right to the set-offs which were awarded him by the judgment of the Superior Court, unless the position of the receiver, with respect to his rights against those indebted to the bank, is a more favorable one than that of an assignee in insolvency; and that it is not is well settled. The receiver is not a *bona fide* holder for value, of the assets of the bank, in the sense that its commercial paper in his hands is protected against defenses which might have been set up against the bank. He succeeded only to the rights of the bank at the time of its failure, and a set-off available against the bank at that time is equally available against him. *Hade* v. *McVay*, 31 Ohio St. 231, and cases cited on page 238.

The remedy of set-off has been much enlarged in equity, and

is there administered in cases where, under the strict rules at law, it would not be available. Thus, at law, a joint demand can not be set off against a several one, nor a several demand against a joint one; but equity adopts a different rule where, on account of the insolvency of one of the parties, the other is in danger of losing his claim. *Sarchet* v. *Sarchet*, 2 Ohio, 320; *Baker* v. *Kinsey*, 41 Ohio St. 403. And generally equity will enforce the right of set-off by decreeing the compensation of mutual demands, so far as they equal each other, where they have grown out of the same or connected transactions, or the one has formed, in whole or in part, the consideration of the other, and the party against whom the set-off is asserted is insolvent.

These equitable grounds for the allowance of the set-offs claimed by the plaintiff are present in the case under consideration. The fund against which the check on the Rochester bank was drawn was the property of the plaintiff, and the check was put in the hands of Gordon to meet the maturing obligation of the plaintiff. In transferring the check to the Fidelity bank, and obtaining from it the draft for $3,200 on The First National Bank of New York, Gordon was the agent of the plaintiff, and the transaction was for the latter's benefit. The check was deposited upon the agreement that the draft should be issued for the specified sum, and the deposit and draft were each the consideration for the other. It is not to be supposed that the transaction would have occurred if the plaintiff or his agent had known at the time of the bank's insolvency. No funds were in the hands of the drawee at the time the draft was issued, nor was any provided with which to meet it on presentation, and therefore presentment and protest were not required in order to fix the liability of the drawer. The failure of the bank to provide the requisite fund to meet the draft, made it necessary, for the plaintiff's protection, to stop the payment of the check; and thus the liability of the plaintiff to the bank on the check, which the receiver seeks to enforce against him, arose from the bank's breach of its obligation, incurred as the consideration, in part, of the deposit of the check. There is nothing lacking here that is essential to a complete equitable right of set-off. And the same is true as to the other set-off allowed. The draft drawn by Gordon on Warner for $1,249.26, was accepted by the latter solely for the accommodation and benefit of the former. They are each liable thereon, it is true; but their relation to each other is that of principal and surety. If an action were brought by the bank against Gordon,

as the drawer of the draft, he would be entitled to a set-off against his liability, the balance standing to his credit on his deposit account with the bank; and he being insolvent, his surety has the right to have the set-off allowed against his liability, which is but a mode of compelling the application of the principal's property to the payment of his own debt, for the relief of his surety. The objection made to this set-off on the ground that the liability on the draft had not matured when the bank failed, has already been disposed of; for, in that respect, it does not differ from the one previously considered.

2. Does section 5242 of the Revised Statutes of the United States forbid the allowance of the set-offs? That section reads as follows:

"Sec. 5242. All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor; all deposits of money, or bullion, or other valuable thing for its use, or for the use of any of its share-holders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in payment of its circulating notes, shall be utterly null and void; and no attachment, injunction, or execution, shall be issued against such association or its property before final judgment in any suit, action, or proceeding, in any state, county, or municipal court."

The right of set-off existed, as has been shown, and the receiver took the claims which the bank held against Warner, subject to that right, unless the section operates to defeat it. The claim of the plaintiff in error is, that, as the liabilities of Warner passed to the receiver before they matured, to allow the set-offs, would interfere with the equal distribution of the bank's assets amongst its creditors, which it was the design of the section to secure. Under other provisions of the United States statutes the comptroller of the currency may appoint a receiver of a national bank, when he is satisfied it is insolvent, or is in default in the payment of its circulating notes; and it is the duty of the receiver to take possession of the assets of the bank, and collect or otherwise convert them into money, and pay the same into the United States treasury, subject to the order of the comptroller, who, after

redeeming the outstanding notes of the bank, is required to make a ratable dividend of the balance among its creditors. The purpose of section 5242 no doubt was to prevent a national bank, when insolvent or in contemplation of insolvency, from so disposing of its assets as to prevent their proper application to the redemption of its notes in circulation, and the ratable distribution of the remainder among its creditors; and its provisions extend no farther than to declare void any disposition by the bank of its choses in action, securities, or other assets, made with the view of preventing their application to the payment of its circulating notes, or with a view to prefer one creditor to another; and to prohibit attachments, injunctions, or executions, against such bank or its property, before final judgment. The section, as we understand it, does not prohibit the allowance of any valid set-off, legal or equitable, which a debtor of a bank may have against any obligation owing to it by him at the time of its insolvency. The allowance of such a set-off is not the creation of a preference, but an ascertainment of the just amount due. To exact the payment of more than that would be unjust, and the section, we think, does not require that to be done. Warner's equitable right of set-off existing at the time of the failure of the Fidelity bank, and his obligations having passed to the receiver subject to that right, only the balance due on those obligations, after deducting the set-offs, constituted assets of the bank in the receiver's hands for disposition in accordance with the provisions of the federal statutes.

Counsel for plaintiff in error cite the case of *Armstrong* v. *Scott*, 36 Fed. Rep. 63, as maintaining a contrary doctrine. But the later cases of *Armstrong* v. *Snyder*, 37 Fed. Rep. 18, and *Yardley, Receiver* v. *Clothier*, 49 Fed. Rep. 337, after a full review and discussion of many authorities, and a careful consideration of the statutes, decline to follow *Armstrong* v. *Scott*. Those decisions are in accord with the views we have expressed, and render it unnecessary to enlarge the discussion here.

We find no error in the record, and the

Judgment is affirmed.

[To appear in 49 Ohio St.]